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STRENGTHENING THE MICRO-ENTERPRISE DEVELOPMENT ACTIVITIES OF PARTNERS FOR DEVELOPMENT IN NIGERIA

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EXECUTIVE SUMMARY

Partners for Development (PFD) initiated micro-enterprise development activities in Benue State, Nigeria in 2000. By 2001, PFD was collaborating with eight non-governmental organizations (NGOs), which were providing micro-finance services in the towns of Makurdi and Otukpo and environs, primarily to traders and farmers. As of May 2002, the eight NGOs had collectively disbursed loans to more than 6,100 clients. They had more than N23,000,000 in loans outstanding and had mobilized more than N2,500,000 in clients' savings. Unfortunately, at least five of the eight NGOs are currently experiencing very serious loan delinquency problems.

Major Findings

The NGOs with which PFD is working were inexperienced in credit management when the collaboration began. They continue to view themselves as charitable, social service institutions, rather than as business-like, financial service institutions. This kind of organizational mind-set has had a negative impact on the organizations' repayment performance; late loan installments are not considered to be unacceptable. The following factors also contribute to the poor repayment performance of the NGOs:

1) Loan products, policies and conditions that are not consistent with micro-finance best practices;

2) Inadequate training of clients, especially with regard to the mutual guarantee mechanism;

3) Management information systems that do not help the managers organize and analyze loan portfolio information (including information on late loans) effectively;

4) The provision of inadequate support to their credit officers.

Although a significant amount of training has been provided to the NGOs over the course of their collaboration with PFD, they have not received enough specific guidance, particularly related to the design of appropriate loan and savings products and the importance of adhering to micro-finance best practices.

Major Recommendations

1) PFD's micro-enterprise development staff should spend the majority of their time in the field, working closely with the NGOs to help them develop effective strategies for controlling delinquency and improving repayment. As part of that effort, they should help the NGOs revise their loan policies and procedures to ensure that their lending methodologies and principles are sound. They should also help the NGOs revise and improve their management information systems, improve their pre-loan training, and determine if they are charging interest rates that are high enough to ensure the long-term viability of their institutions (assuming, of course, that they will be able to control delinquency).

2) PFD should ensure that the NGOs are complying with any prudential regulations that apply to deposit-taking institutions in Nigeria.

3) PFD should ensure a steady, uninterrupted flow of resources (for operations and loan funds) to the NGOs with which it develops new contracts through the end of 2004.

4) The NGOs should review their loan and savings policies and procedures and revise them if they are not consistent with micro-finance best practices.

5) The NGOs should develop and implement detailed action plans for controlling and managing delinquency and improving repayment.

6) The NGOs should determine the effective interest rate that they should be charging, calculate their current effective interest rate, and make adjustment to their nominal rate, if necessary.

7) The NGOs must ensure that their credit officers have sufficient resources (transportation, supplies, etc.) and motivation to carry out their jobs effectively, and that they are adequately supervised.

OVERVIEW OF THE MICRO-ENTERPRISE DEVELOPMENT ACTIVITIES OF PARTNERS FOR DEVELOPMENT IN NIGERIA

Background

Partners for Development's activities in Nigeria are designed to:
1) Increase income among poor households and individuals by improving access to credit;
2) Improve marketing through the repair and construction of feeder roads;
3) Develop the capacity of the Nigerian NGOs involved in the implementation of the credit and marketing activities;
4) Improve knowledge and practices related to reproductive health and HIV/AIDS, primarily among the participants in the credit activities.

Partners for Development initiated micro-enterprise development activities in Benue State in 2000. In July 2000, the Community Development Foundation (CDF), a Lagos-based micro-credit NGO, was hired as a consultant by PFD to organize a micro-credit workshop in Makurdi, to which many local NGOs were invited. NGOs that became interested in providing micro-credit services were visited and assessed by CDF and were asked to submit a profile of their organization and a proposal. PFD evaluated these proposals, assessed the organizational capacity of these potential partner NGOs, and ultimately selected eight of them. Two of these NGOs – Anglican Diocesan Development Services (ADDS) and Health and Development Organization (HADO) – began working with PFD in November 2000. The other six – Ohonyeta Care Group (OCAG), Ankpa Ward Circuit Women and Widow's Foundation Association (Methodists), Osa Foundation Association (OSA), Otia Development Foundation (OTIA), Women in Nigeria, Benue Chapter (WIN), and Health and Development Services (HADSERVS) – signed collaborative agreements with PFD in May 2001.

PFD intends to expand its micro-enterprise development activities into Nassarawa State in the near future through partnerships with two or three new NGOs.

For its eight NGO partners, PFD has provided:
1) A grant of approximately one year's funding to cover a portion of the NGOs' operational costs;
2) Loan capital, in quarterly installments (after PFD has reviewed with the NGO its performance in the previous quarter).

Over the course of its collaboration with the eight NGOs, PFD has provided a significant amount of training to them, either directly or through local training institutes (CDF and Lift Above Poverty Organization). This training has included the following topics:
1) General principles of financial services and financial management;
2) Basic tools for accounting and loan portfolio management and reporting;
3) Factors that should be considered when determining the interest rate;
4) Different loan and savings products;
5) Impact monitoring and evaluation of micro-credit programs;
6) Indicators for measuring financial sustainability;
7) Loan delinquency management;
8) Enhancing the NGOs' ability to offer technical advice on micro-business management to clients;
9) Pre-loan training.

By April 2002, more than 6,100 individuals had benefited from loans provided by PFD's NGO partners in Benue State. As of the end of April, the eight NGOs collectively had more than N23,300,000 in loans outstanding and had mobilized over N2,500,000 in savings. The NGOs were offering a wide variety of different loan products to their clients. (In Appendix I, see Tables 1 and 2 for a description of the terms/conditions of the NGOs' various loan products and Table 3 for a description of their savings policies). Approximately two-thirds of the loans had been provided for trading activities. Most of the remaining loans had been provided for agriculture and food processing, while a small number of loans had been provided to groups for collective activities like rice milling or groundnut storage. Unfortunately, most of the NGOs are currently experiencing very serious loan repayment problems. At least 4 of PFD's partner NGOs (OSA, OCAG, WIN, and HADSERVS) had more than 20% of the total value of their loan portfolios in arrears at the end of May 2002, while 49.0% of the value of ADDS's portfolio was at risk.

Table 4: Quality of the NGOs' Loan Portfolios (May 2002)

NGO	Loans Outstanding	Portfolio in Arrears	Portfolio at Risk
OSA	4,625,499	986,555 (21.3%)	1,324,605 (28.6%)
OCAG	1,267,890	359,655 (28.4%)	N/A
WIN	808,046	180,026 (22.3%)	N/A
HADO	2,978,170	96,750 (3.2%)	N/A
Methodists	374,026	14,674 (3.9%)	26,353 (7.0%)
HADSERVS	2,494,080	1,634,080 (65.5%)	N/A
ADDS	3,103,079	87,500 (2.8%)	1,521,439 (49.0%)
OTIA	7,671,840	51,500 (0.7%)	N/A

The other three NGOs appear to be doing a much better job of controlling delinquency, but it would be useful to know the portfolio at risk ratios for all of the NGOs. Several of the NGOs reported portfolio at risk ratios that were lower than their portfolio in arrears ratios, which is not possible. Some of the NGOs may be under-reporting the true value of their portfolio in arrears.

Consultant's Observations

The institutional partners that PFD selected for its micro-enterprise development activities are small and relatively unsophisticated non-governmental organizations (NGOs) that need a great deal of technical support to develop or strengthen their overall systems and operations, particularly with regard to credit management. Only two of the NGOs had had any experience with financial services prior to their partnerships with PFD. On the positive side, these NGOs are local, community-based organizations that know the areas in which they operate very well and have a clear commitment to work with poor people. They have close relationships with local community leaders and presumably have some understanding of the activities, household livelihood strategies, financial situation, and needs of potential financial services clients.

On the other hand, these NGOs, as social assistance organizations, do not yet possess the required professional expertise or business culture to efficiently execute credit operations. They will have to undergo a substantial transformation if they intend to provide financial services on a sustainable basis. Instead of serving "beneficiaries," they must think of themselves in contractual relationships with clients. They must learn that if they truly want to achieve their social goals, they must act in a more business-like way. The "social service" or "charitable" mind-set of many of the NGOs is having a definite, negative impact on their approach to controlling and managing delinquency. Also negatively affecting repayment rates are:

1) Questionable loan and savings products, policies, and procedures that are not consistent with the best practices of micro-finance.

2) Inadequate training for groups and individual borrowers. One of the most glaring weaknesses in this regard is the lack of attention that is given to the mutual guarantee (or cross guarantee or joint liability) mechanism when loans are made to groups. The mutual guarantee mechanism is absolutely critical to ensuring high repayment rates, since poor clients can provide very little or no collateral, and since other forms of collateral substitutes (such as the use of guarantors) are much less effective. However, the importance of the mutual guarantee mechanism is not emphasized by many of the NGOs during pre-loan training or as part of their strategy for managing loan delinquency (a few of the NGOs do not use it at all). The NGOs' clients would also benefit from some basic business education/training (feasibility of a proposed business; managing business money; determining profitability; increasing sales; etc.).

3) Inadequate management information systems. All of the NGOs have basic accounting systems that enable them to track revenue and expenditures, but none of them are currently able to produce a balance sheet or an income statement; many cannot even do a bank reconciliation. Many of the NGOs' loan portfolio management systems are poorly designed. For most of the organizations, the system consists exclusively of the loans/savings ledger. It is difficult for many of them to extract accurate information that the managers need on a timely basis to manage their loan portfolios effectively, analyze trends over time, and report accurately to PFD and other stakeholders.

4) Inadequate support and supervision of credit officers. In any micro-finance institution, the credit officers are the most important members of staff, since they interact directly with the clients on a daily basis. One of the elements most critical to ensuring high repayment rates is frequent contact with the clients by the credit officers to monitor repayment and help the clients resolve any problems that might arise. Therefore, it is extremely important for the micro-finance institution to ensure that their credit officers have all the resources they need and are sufficiently motivated to do their jobs effectively. In addition, they must be adequately supervised to reduce the risk of fraud. In the case of PFD's partner NGOs, many of the credit officers were unable to get to the meetings of their clients on time, due to inadequate transportation, and there was very little monitoring or supervision of the work of the credit officers in the field.

5) Written policies and procedures (documented in manuals and other documents) that are often not consistent with actual practice.

As mentioned above, PFD and local consultant organizations (CDF and Lift Above Poverty Organization), have provided a significant amount of training to the NGOs. However, the NGOs have not been given enough specific and practical guidance and training on:

1) Micro-finance best practices;

2) How to develop appropriate loan and savings products and policies;

3) The design of an appropriate and effective management information system;

4) How to train clients (particularly in terms of their responsibilities related to loan repayment);

5) How to monitor loan repayment performance;

6) How to manage loan delinquency.

PFD's micro-enterprise development staff is quite capable of monitoring the micro-enterprise development activities of PFD's NGO partners. Both Friday Ekosini and Teryima Uza would, however, benefit from additional training in micro-finance. They should spend as much time as possible in the field, working with PFD's NGO partners to help them improve their operations. They should analyze the loans/savings ledgers of the NGOs to determine the true extent of the repayment crisis. They should follow up on the following issues/activities that were initiated during the July 2002 training workshop:

a. Assist the NGOs to develop and implement plans to revise general policies/procedures, as well as specific loan terms and conditions, so that they are more in line with micro-finance best practices.

b. Assist the NGOs to develop and implement more detailed action plans to control and manage delinquency and improve repayment.

c. Help the NGOs finalize their long-term planning through 2004 and their estimate of loan portfolio size and costs for that year, so that they will be able to calculate the effective interest rate that they should be charging; ensure that they are able to calculate their current effective interest rate.

d. Help the NGOs develop a detailed training curriculum for pre-loan training.

e. Ensure that the NGOs are accurately completing the Monthly Portfolio Report and Monthly Financial Report. Also, help them to determine how to use/revise the other suggested reports in order to improve their ability to monitor their micro-finance activities and improve repayment.

PFD should continue to focus its efforts on "micro"-enterprise development; at this point, it should not encourage its NGO partners to offer "small" loans. PFD should also ensure that the NGOs are complying with any prudential regulations that apply to deposit-taking institutions in Nigeria.

PFD should ensure a steady, uninterrupted flow of resources (for operations and loan funds) to the NGOs with which it develops new contracts through the end of 2004 (unless a contract is annulled for performance reasons). In addition to budgets for operating expenses, the NGOs should prepare, with the assistance of PFD, financial projections that would enable them to determine their cash flow needs related to their credit funds. In the past, there was apparently some confusion concerning the duration of the agreements that the NGOs signed with PFD; no duration was specified in the Memoranda of Understanding. In the case of ADDS, for example, the NGO was told that the first phase of the project would last eighteen months, although ADDS submitted a project proposal and budget for only twelve months. Since the end of 2001, when funding ended, ADDS has been covering operating expenses with retained earnings. It is unclear if ADDS has adequate loan funds available to meet its clients' demands for additional loans. Because ADDS has not done financial projections and does not prepare cash flow analysis reports, it is impossible to tell when the organization will run out of funds and have its credit operations disrupted. When a micro-finance institution is unable to provide new loans to clients who repay on time, or if credit operations are otherwise disrupted due to lack of funds, repayment problems are usually exacerbated.

OTHER RECOMMENDATIONS

General Recommendations Related to the NGOs' Micro-Finance Operations

1. In general, the NGOs must become more business-like. Currently, the NGOs do not seem to have a sufficiently strong commitment to on-time repayment (an organizational philosophy that late loans are simply unacceptable).

2. The NGOs should review their loan and savings policies and procedures and revise them if they are not consistent with micro-finance best practices (sound principles and methodology). (Many specific recommendations related to these best practices are outlined in the following section).

3. The NGOs should develop and implement detailed action plans for controlling and managing delinquency and improving repayment.

4. The NGOs should engage in long-term planning, including financial projections and cash flow planning, through 2004.

5. Using the pricing formula that was reviewed during the July 2002 training, the NGOs should determine the effective interest rate that they should be charging, calculate their current effective interest rate, and make adjustment to their nominal rate, if necessary.

6. The NGOs' policy documents should be consistent with actual practice. For example, an NGO should not indicate in its documents that it is paying depositors interest on their savings if, in practice, it is not. The NGOs should make their policies, procedures, terms, and conditions as simple as possible and ensure that they are clear to staff and clients.

7. The NGOs must ensure that their credit officers have sufficient resources (transportation, supplies, etc.) and motivation to carry out their jobs effectively, and that they are adequately supervised.

Specific Recommendations Related to NGOs' Savings and Loan Products, Policies and Procedures

1. The NGOs should offer one, or at most two, loan products.

2. The NGOs should work with groups rather than individuals whenever possible. This would improve the efficiency of their lending operations and would enable them to put the mutual guarantee mechanism into practice.

3. The NGOs should provide new borrowers with small loans and progressively increase the maximum amount for each subsequent stage. Approval of subsequent loans should be based on repayment performance and should not require detailed analysis by senior management staff of the NGO. In fact, responsibility for loan analysis and approval should be devolved to the solidarity groups and credit officers. The groups should be trained to do a basic analysis of each borrower's loan request, focusing on the following important considerations:
    - Are the necessary inputs available for the proposed activity?
    - Are there markets for the borrower's proposed products or services?
    - Does the borrower have the requisite skills and experience?
    - Will the proposed activity generate a profit?
    - Will the borrower's business cycle permit her/him to make the installment payments without difficulty?

- Has the borrower considered the risks associated with the proposed activity and does she/he have a plan to manage the risks?

The credit officer should ensure that the group members conduct a serious analysis and that it rejects inappropriate activities or loan amounts. Making the group members responsible for loan analysis/approval would help to strengthen the mutual guarantee system.

8. The mutual guarantee is fundamental to the success of group lending to poor borrowers. Because poor borrowers generally do not have collateral, the peer pressure that is generated through the mutual guarantee system is essential to ensure high repayment; other types of collateral substitutes tend to be less effective. The mutual guarantee system must be emphasized by the credit officers during the pre-loan training. The group members must understand their responsibilities with regard to analyzing and approving loans, ensuring that the members invest their loans in the activities for which they were approved, and ensuring that there is full repayment by the group at each installment date (each member should understand her/his obligation to contribute if other members are unable, for any reason, to repay). Groups should meet prior to the dates on which the installments are due, so that they can determine if any member will have a problem repaying and decide how to resolve the problem. The credit officer should remind the group members of their obligations at the groups' regular meetings. If the installment payment is not complete, the credit officer should insist that the group take action to resolve the problem immediately. Some NGOs provide new loans to group members who have completed repaying their individual loans, even if the group loan is in arrears; this policy obviously destroys the effectiveness of the group guarantee.

9. In addition to the mutual guarantee system, the pre-loan training should cover:
   - The NGO's mission/objectives;
   - Loan policies (including the term, interest rate, fees and dues, repayment frequency, etc.);
   - Savings requirements and policies;
   - Roles and responsibilities of group leaders;
   - Record keeping. (The NGOs should not have to keep records on the repayments and savings of individual members. This should be done at the group level, with the credit officer verifying that the records are up to date and accurate);
   - The development or strengthening of group by-laws to help ensure meeting attendance and repayment.
   - The benefits of repayment and the costs of late or non-repayment.

10. To encourage borrowers to repay their loans on time, the NGOs should ensure that groups with good repayment records receive new loans within one or two weeks of the end of the loan term.

11. The NGOs should review their savings policies. All of them require mandatory savings and block withdrawals until the loan has been completely repaid; some block withdrawals until the client quits the program. Requiring (and blocking) a small percentage (usually, around 5%) of the value of the loan amount as collateral, for the length of the cycle, is fine. More onerous mandatory savings requirements, on the other hand, discourage poorer potential clients from participating. To encourage voluntary savings, withdrawals during the cycle should be permitted (blocking only the mandatory minimum amount as collateral). Clients should be able to make withdrawals at their regular meetings; the groups should keep individual records on savings deposits and withdrawals, as well as repayments. Clients should have access to the entire amount saved at the end of the cycle, with the caveat that the client would be required to deposit a mandatory minimum amount (if that is the NGO's policy) before receiving a subsequent loan. Blocking access to savings until the end of participation in the program discourages saving and probably actually encourages long-term clients (the NGOs' best clients, who are producing the most revenue for the organizations), who have built up a significant amount of savings, to leave the program.

12. Loans for trading should be short-term (4 – 6 months) and repayment should be frequent (weekly or bi-weekly repayments are recommended for initial loans). It is recommended that the NGOs eliminate grace periods.

13. Given the complicated nature of agricultural lending, including the higher risks involved and the greater level of institutional capacity required to make it successful, it is recommended that the NGOs focus exclusively, or almost exclusively, on loans for trading and services (activities that have a high turnover and generate regular income flows). If farming loans are provided, the NGOs should take the seasonal nature of farming activities into account.

14. Groups should self-select members; NGO staff should not form the groups.

4-6 members

15. To be effective, the solidarity groups (or mutual guarantee or joint liability groups) should contain only 4 to 6 members (all of the members must know one another very well; peer pressure does not work as well in larger groups). It is possible (in fact, it is more efficient) for the NGOs to work with larger groups – and even to insist on joint liability among the members of the groups – but there should be smaller solidarity groups within them. All group members should live in the same community. The NGOs should not encourage all group members to do the same activities, but the members should have similar loan sizes and similar business cycles. The NGOs should be discouraged from working with mixed-gender groups.

16. If interest is collected up front (at the beginning of the loan term), one must ensure that the borrower has sufficient principal remaining to meet the cash flow needs of her/his business.

Recommendations Related to the NGOs' Management Information Systems

1. For reporting to PFD, the NGOs should begin using the new "Monthly Portfolio Report" and "Monthly Financial Report: Summary of All Operations" (which is essentially an income statement) immediately in place of the old "Reporting Format." (These new reports, as well as other suggested reports, can be found in Appendix III).

2. Each of the NGOs should establish a loan loss reserve on the basis of an aging analysis (see the Loan Aging Report in Appendix III). Loan loss provisions should be recorded on the monthly financial report (income statement) to make adjustments to the reserve.

3. It is recommended that the NGOs establish separate bank accounts for their operations and credit funds. They could monitor the activity in these accounts by completing, respectively, the "Monthly Operations Account Summary" and the "Statement of Loan Fund Cash Position by Credit Bank Account" (see Appendix III). A "Monthly Operations Account Summary" would be completed for each operations account, including petty cash accounts.

4. The NGOs should complete bank reconciliations for each of their bank accounts on a monthly basis.

5. It is recommended that the NGOs use the "Monthly Loan/Savings Activity Summary" and the "Monthly Arrears Report" (see Appendix III) to help them organize the information contained in the "Loans/Savings Ledger" and track the performance of the loan portfolio on a monthly basis.

6. Loan agreements should include a schedule of repayments, indicating the exact amounts (principal and interest) due and the exact due dates. The agreements should be signed by a representative of the

NGO.

Recommendations Related to the NGOs' Systems for Impact Monitoring and Evaluation

The NGOs used to collect the following data at the beginning of each new loan cycle:

- Name of borrower;
- Address;
- Date of loan;
- Amount of loan;
- Purpose of loan;
- Average monthly sales;
- Number of children of school age (under 18);
- Number of children in school;
- Proposed use of additional income

The reason for collecting this information was to track business growth and program impact, in particular the impact on the education of clients' children. However, the NGOs stopped collecting this information some time ago. There is at present no effort to conduct impact monitoring.

Impact monitoring and evaluation is certainly not as high a priority as controlling and managing delinquency or improving credit policies and operations. Nevertheless, once the more pressing problems are addressed, it will be very important to try to measure and explain changes that occur at the client level. Therefore, the consultant left a number of impact monitoring and evaluation tools/guidelines with PFD's micro-enterprise development staff. These tools/guidelines focus on management-oriented measurement systems and place impact monitoring and assessment within the larger framework of on-going organizational activities. They can provide both quantitative and qualitative information.

The PFD staff should help the NGOs adapt the survey tools to meet their own needs and the needs of their donors. The longitudinal impact survey, for example, may be too complicated, time-consuming, and expensive for most of the NGOs to use. However, some of the impact-related questions that the NGOs consider to be most important could be extracted from the questionnaire and included in a longitudinal client monitoring system that collects information on a regular basis from a sub-set of clients – at the beginning of each loan stage, for example. Unfortunately the NGOs at this point do not have the resources or the capacity to manage computer databases. Therefore, the tools that provide qualitative information on loan use, client satisfaction, and client empowerment, or the tools designed to help institutions understand the reasons why clients drop out of their credit programs, might be to be more useful to the NGOs.

APPENDIX I: NGOs' LOAN TERMS/CONDITIONS AND SAVINGS POLICIES

Table 1: Terms/Conditions of NGOs' Loan Products

	ADDS **Trading Loan**	**HADO** **Coop Loan**	**HADO** **Group Loan**	**METHODISTS** **Trading Loan**	**METHODISTS** **Christmas Loan**	**OCAG** **3-Month Loan**	**OCAG** **6-Month Loan**
Only to Members?	Yes	Yes	Yes	No	No	Yes	Yes
For What Purpose?	Trading; machinery for corn/rice milling	Milling machines and groundnut storage, etc.	Trading	Trading	Trading	Trading	Trading
To Individuals or Groups?	Individuals within groups	Groups	Individuals within groups	Individuals within groups	Individuals within groups	Both	Both
Pre-Existing or New Groups?	Both	Pre-existing	Both	New	Pre-existing (Trading loan groups)	Both	Both
Contract with Group or Individuals?	Group	Group	Individuals within group	Individuals within group	Individuals within group	Both	Both
Group Size?	10 – 50	30 – 35	5	5 - 10	5 – 10	5	5
All Members of Group Required To Be in Same Business?	No	Yes	No	No	No	No	No
Does Access to Loans Rotate?	Yes	No	No	No	No	No	No
Frequency of Meetings?	Fortnightly or monthly	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly

	ADDS Trading Loan	HADO Coop Loan	HADO Group Loan	METHODISTS Trading Loan	METHODISTS Christmas Loan	OCAG 3-Month Loan	OCAG 6-Month Loan
Dues Required?	No	N50 per group per month	N20 per member per month	N20 per member per month	N20 per member per month	No	No
Fees Required?	Membership: N1,000/group Application: N250/group	Registration: N1,000/group	Registration: N100/person	Registration: N10/person Application: N100/person	Registration: N10/person Application: N100/person	Registration: N100/person	Registration: N100/person
Guarantees Required?	Cross guarantee; Head of community as guarantor	Two civil servants must act as guarantors	One civil servant must act as guarantor; cross-guarantee	Cross-guarantee; 2 Methodist Church guarantors	Cross-guarantee; 2 Methodist Church guarantors	Cross-guarantee; center leaders serve as guarantors	Cross guarantee; center leaders serve as guarantors
Nominal Interest Rate?	2% per month (24% per annum)	30% for 15 months (24% per annum)	30% for 8 months (45% per annum)	20% for 9 months (26.7% per annum)	5% per month (60% per annum)	10% for 3 months (40% per annum)	20% for 6 months (40% per annum)
Maximum Loan Sizes?	1st: N10,000 2nd: N15,000 3rd: N20,000	1st: N250,000 per group 2nd: N500,000 per group	1st: N5,000 2nd: N10,000	N20,000	N100,000	1st: N5,000 2nd: N10,000 3rd: N15,000 Ceiling: N50,000	1st: N5,000 2nd: N10,000 3rd: N15,000 Ceiling: N50,000
Interest Collected Up-Front?	Yes	No – Regular installments	Yes, beginning in the second stage	No – Regular installments	Yes	No – Regular Installments	No – Regular Installments
Loan Term?	7 – 9 months	15 months	8 months	9 months	3 – 5 months	3 months	6 months
Grace Period?	Yes	No	Yes	No	N/A	No	No
Frequency of Repayments?	Monthly	Monthly	Weekly	Monthly	One lump sum payment at end of term	Weekly; Fortnightly; or Monthly	Weekly; Fortnightly; or Monthly

Table 2: Terms/Conditions of NGOs' Loan Products

	WIN Trading Loan	HADSERVS Short Term Loan	HADSERVS Long Term Loan	HADSERVS Business Loan	OSA Short Term Loan	OTIA Trading Loan	OTIA Farming Loan	OTIA Pensioner Loan
Only to Members?	No	No	No	No	No	Yes	Yes	No
For What Purpose?	Trading	Trading	Trading, Farming, or Joint Ventures	Trading	Trading, poultry raising, pottery, etc.	Trading	Farming	Any purpose
To Individuals or Groups?	Individuals within groups	Both	Both	Individuals	Individuals within groups	Both	Individuals within groups	Bank administers to individuals
Pre-Existing or New Groups?	Both	New	Both	N/A	Both	Both	Both	N/A
Contract with Group or Individuals?	Group	Group	Group	Individuals	Group	Individuals and individuals within group	Group	Individuals
Group Size?	5 - 10	5 - 10	5 - 30	N/A	5 – 10	5	5	N/A
All Members of Group Required To Be in Same Business?	No	No	Yes for joint ventures; no for trading or farming	N/A	Yes	No	No	N/A
Does Access to Loans Rotate?	No	Yes	No	N/A	No	Yes	No	N/A
Frequency of Meetings?	Unknown	Monthly	Monthly	N/A	Monthly	Weekly	Monthly	N/A

	WIN Trading Loan	HADSERVS Short Term Loan	HADSERVS Long Term Loan	HADSERVS Business Loan	OSA Short Term Loan	OTIA Trading Loan	OTIA Farming Loan	OTIA Pensioner Loan
Dues Required?	No	No	No	No	No	N20/month/ person	No	No
Fees Required?	Registration: N200/person	Registration: N200/person; N500/group	Registration: N200/person; N500/group	Registration: N500/person	Stage 1: N1600/group; Stage 2: N600/group	Registration: N200/person	Registration: N200/person	None charged by OTIA
Guarantees Required?	Cross guarantee; 2 guarantors (including group leader)	Guarantors	Guarantors	Guarantors	2 guarantors (including group leader)	Cross guarantee and one guarantor	Cross guarantee and one guarantor	Pension paid into bank; payment deducted before pensioner is paid
Nominal Interest Rate?	30% per annum	10% for 5 months (24% per annum)	20% for 9 months (26.7% per annum)	12% for 3 months (48% per annum)	10% for 4 months (30% per annum)	30% for 44 weeks (35.5% per annum)	30% for 52 weeks (30% per annum)	30% for 52 weeks (30% per annum)
Maximum Loan Sizes?	1st: N5,000 2nd: N10,000	N20,000 per person; N250,000 per group	N150,000 per group	N300,000 per person	1st: N10,000 2nd: N15,000 3rd: N20,000	1st: N5,000 2nd: N10,000 3rd: N15,000	1st: N20,000	N20,000
Interest Collected Up-Front?	Yes	No – Regular installments	No – 2 installments	No – 1 lump sum payment at end of term	No	No – Regular installments	No – 1 lump sum payment at end of term	No – Regular installments
Loan Term?	4 months; 6 months; 8 months	5 months	9 months	3 months	4 months	44 weeks	52 weeks	52 weeks
Grace Period?	No	Yes	Yes	Yes	Yes	No	Yes	No
Frequency of Repayments?	Monthly	Monthly	Pay half at 6 months; half at 9 months	One lump sum payment at end of term	Monthly	Weekly	One lump sum payment at end of term	Monthly

Table 3: NGOs' Savings Policies

	ADDS	HADO	Methodists	OCAG	WIN	HADSERVS	OSA	OTIA
Length of Time Client Must Save Before First Loan?	2 – 3 months	2 – 3 months	No requirement	1 – 2 months	1 – 2 months	No requirement	No requirement	4 weeks
How Much Must Client Save Before First Loan?	N600	N20/week, but No set minimum	No requirement	10% of value of loan – for first and subsequent loans	N400 before first loan; N2,000 before subsequent loans	No requirement	No requirement	N100
How Much Must Client Save During Loan Cycle?	N50/week	Coops: N200/ month/group; Other groups: N20/person/ week	N100/month	N160/month	N50/week	N200/month	N200/month (but not enforced)	N20/week
How Frequently Must Client Save?	Weekly	Coops: Monthly; Clients in other groups: Weekly	Monthly	Monthly	Weekly	Monthly	Monthly	Weekly
Withdrawals Permitted Before End of Loan Term?	In theory, yes, but not permitted in practice	No	No	No	In rare cases (death of family member)	No	No	Policy permits withdrawal of voluntary saving but not practiced
Withdrawals Permitted at End of Loan Term?	In theory, yes, but in practice only if client quits program	Yes, but only if client quits program	Yes, but only if client quits program	Yes	Yes, but only if client quits program	No – only after one year in the program	Yes, but only if client quits program	Yes, but only if client quits program
Interest Paid on Savings?	2%/annum is policy – but not yet paid	No	No	No	No – when client withdraws WIN deducts 20% from total savings	2%/annum is policy – but not yet paid	3%/annum if client saves N200 per month for 12 months – but not yet paid	No
Savings Loaned out by NGO?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

APPENDIX II: DEFINITION OF TERMS

Collection rate: the amount of principal paid during the month (including late loans but excluding prepayments) divided by the amount of principal that was due in the month (including all late loans).

Defaulted loans: loans that are not expected to be recovered (and may have been written off).

Delinquent loans: principal that is due but that has not been paid. Synonymous with "late loans," "loans in arrears," "loans past due," and "loans overdue."

Loan loss provision: the amount expensed in a period to increase the loan loss reserve to an adequate level to cover expected defaults of the loan portfolio. It is based on the difference between the required loan loss reserve and the current outstanding loan loss reserve.

Loan loss reserve: an account that represents the amount of outstanding principal that is not expected to be recovered. It is the amount "reserved" to cover losses of the loan portfolio. It is recorded as a negative (or contra) asset on the balance sheet. An adequate loan loss reserve is determined through an aging analysis of late loans.

Loans written off: the amount declared non-recoverable (usually, after more than 180 days in arrears) in the month.

Number of borrowers: includes all individuals within groups who have loans outstanding, even if the NGO's contract is with the group.

Number of clients: the number of both borrower/savers and savers. Individuals within groups should be counted, even when the loans are made to groups.

Number of clients withdrawn: the number of clients who quit the program before their group receives a loan or after their individual or group loans were repaid or written off.

Number of groups dissolved: the number of groups that quit the program before they received a loan or after their loans were repaid or written off.

Number of loans disbursed: includes all loans to individuals within groups, even if the NGO's contract is with the group.

Portfolio at risk ratio: the ratio of the outstanding balance of all loans that have an amount overdue to the total amount of principal outstanding.

Portfolio in arrears ratio: the ratio of overdue loan principal to the total amount of principal outstanding.

Types of Loans

Agriculture:	loans for farming activities.
Food Processing:	loans for milling, garri processing, fruit juice production, brewing, and palm and groundnut oil production.
Services:	loans for food vending, hair dressing, etc.
Trading:	loans for buying and selling goods.

Value of outstanding balance of loans in arrears: includes the total amount of loans outstanding, including the amount that has not yet become due, of loans that have an amount in arrears.

Value of payments in arrears: includes only the amount that has come due and not been received.

APPENDIX III: SUGGESTED REVISIONS TO THE MANAGEMENT INFORMATION SYSTEM

Monthly Portfolio Report

NGO: ______________________________
Preparer: ____________________________
Month/Year: __________________________

I. General Information

1. Number of clients at the end of the month ____________
2. Number of groups at the end of the month ____________
3. Number of women clients at the end of the month ____________
4. Number of men clients at the end of the month ____________
5. Number of clients withdrawn this month ____________
6. Number of clients died this month ____________
7. Number of groups dissolved this month ____________
8. Number of borrowers with loans outstanding at the end of the month ____________
    a. Number of men borrowers ____________
    b. Number of women borrowers ____________
9. Number of credit officers at the end of the month[1] ____________

II. Loans

10. Number of loans disbursed this month ____________
11. Number of loans disbursed to date ____________
12. Amount of loans disbursed this month ____________
13. Amount of loans disbursed to date ____________
14. Type of loans granted this month for the following activities:
    - Agriculture ____________
    - Food processing ____________
    - Trading ____________
    - Services ____________
    - Other ____________

[1] Credit officers include both PFD-funded and others.

III. Repayment

15. Total amount of principal (due plus arrears) due this month ______

16. Total amount of principal repaid this month ______

17. Prepayments of principal this month ______

18. Amount of interest and penalties paid this month ______

19. Amount of loans outstanding at the end of the month ______

20. Amount of principal in arrears at the end of the month ______

21. Number of borrowers in arrears at the end of the month ______

    a. Number of groups in arrears at the end of the month ______

22. Balance of borrowers with late loans at the end of the month ______

    a. Balance of groups with late loans at the end of the month ______

23. Number and amount of late loans by age at the end of the month

    a. 1 – 30 days ______ ______

    b. 31 – 60 days ______ ______

    c. 61 – 90 days ______ ______

    d. 91- 120 days ______ ______

    e. 120 – 180 days ______ ______

    f. More than 180 days ______ ______

24. Amount of loans written off this month ______

IV. Savings

25. Number of savers at the end of the month ______

26. Total amount of savings at the end of the month ______

V. Ratios

27. Collection rate this month: (line 16 minus line 17) divided by line 15 ______

28. Portfolio in arrears rate at the end of the month: line 20 divided by line 19 ______

29. Portfolio at risk rate at the end of the month: line 22 divided by line 19 ______

30. Operating cost per loan made: line 26 from Monthly Financial Report divided by line 10 ______

31. Operating cost per Naira lent: line 26 from Monthly Financial Report divided by line 12 ____________

32. Borrowers per credit officer: line 8 divided by line 9 ____________

33. Amount lent per credit officer: line 12 divided by line 10 ____________

34. Average size of loans disbursed this month: line 12 divided by line 10 ____________

35. Operational self-sufficiency ratio [Note: Calculate at the end of March, June, September, and December for the previous 6-month period: From the Monthly Financial Reports: lines 3 divided by (lines 4 plus lines 6 plus lines 26)] ____________

Monthly Financial Report: Summary of All Operations

Preparer: ______________________________
NGO: ______________________________
Reporting Period (Month/Year): ______________________________

Financial Revenues

1. Interest/Fees/Dues Revenue from Borrowers ____________
2. Interest on Investments ____________

3. Total Financial Revenues (line 1 plus line 2) ____________

Financial Costs

4. Cost of funds ____________

5. Gross Financial Margin (line 3 minus line 4) ____________

6. Provision for loan loss ____________

7. Net Financial Margin (line 5 minus line 6) ____________

Operational Costs

8. Transport ____________
9. Hotel Accommodation ____________
10. Entertainment ____________
11. Furniture, Fittings and Equipment ____________
12. Office Maintenance/Utilities ____________
13. Staff Training ____________
14. Clients' Training ____________
15. Vehicle Maintenance ____________
16. Stationery/Office Supplies ____________
17. Rents ____________
18. Salaries and Allowances ____________
19. Honoraria ____________
20. Publications/Printing/Photocopying/Typing ____________
21. Communication ____________
22. Bank Charges ____________

23. Depreciation ____________

24. Auditing Fees ____________

25. Other Operational Costs ____________

26. Total Operational Costs (add lines 8 - 25) ____________

Other Operating Revenues

27. Other operating revenue (sale of forms, etc.) ____________

28. Net Operating Income/Loss (line 7 minus line 26 plus line 27) ____________

Other Revenues

29. Grants ____________

30. Other (describe) ____________

31. Total Other Revenues (line 29 plus line 30) ____________

Other Expenditures

32. Capital Purchases (list): ____________________
____
____________________ ____________

33. Other (describe): ____________________________ ____________

34. Total Other Expenditures (line 32 plus line 33) ____________

35. Net Income/Loss (line 28 plus line 31 minus line 34) ____________

Monthly Operations Account Summary

(Complete one report for each bank account and petty cash account used for operations)

Preparer: ______________________________

NGO: ________________ ________________

Bank account no: __________ ________________

Reporting Period (Month/Year): ________________

I. Operations

1. Beginning cash balance (last month's ending cash balance) ____________

Financial Income

2. Interest from bank, other investments ____________

Financial Costs

3. Cost of capital – paid ____________

Operational Costs

4. Transport (to clients) ____________

5. Hotel Accommodation ____________

6. Entertainment ____________

7. Furniture, Fittings and Equipment ____________

8. Office Maintenance ____________

9. Staff Training ____________

10. Clients' Training ____________

11. Vehicle Maintenance ____________

12. Stationery ____________

13. Rents ____________

14. Salaries and Allowances ____________

15. Honoraria ____________

16. Publications/Printing ____________

17. Communication ____________

18. Bank Charges ____________

19. Other Operational Costs ____________

20. Total Operational Costs (add lines 4 - 19) ____________

Other Revenues

21. Grants ____________

22. Other (list): ____________________
____
____________________ ____________

23. Total Other Revenue (add lines 21 – 22) ____________

24. Net Change in Cash (line 2 minus line 3 minus line 20 plus line 23) ____________

II. Non-Operations

Transfers In

25. Transfers from (list all): ____________________
____
____________________ ____________

Transfers Out

26. Transfers to (list all): ____________________
____
____________________ ____________

Purchase of Capital Equipment

27. Purchase of new capital equipment (list all): ____________________
____
____________________ ____________

28. Total Change in Account (line 24 plus line 25 minus line 26 minus line 27) ____________

29. Ending Cash Balance (next month's beginning cash) (line 1 plus line 28) ____________

Statement of Loan Fund Cash Position by Credit Bank Account

(Complete one statement for each credit bank account)

Preparer: ______________________________

NGO: ______________________________

Bank account no.: ______________________________

Reporting Period (Month/Year): ______________________

1. Beginning Cash Balance (last month's ending cash balance) ____________

Loan Activity

2. Amount of principal repaid ____________
3. Amount of interest and penalties paid ____________
4. Amount of fees and dues paid ____________
5. Amount of new loans made ____________
6. Interest from bank, other investments ____________
7. **Total Loan Activity** (line 2 plus lines 3 and 4 minus line 5 plus line 6) ____________

Transfers In

8. Transfers in (list all):
   8a. Savings deposits ____________
   8b. Grants ____________
   8c. From other account (indicate source): ________________ ____________
   8d. From other account (indicate source): ________________ ____________
9. **Total Transfers In** (lines 8a – 8d) ____________

Transfers Out

10. Transfers out (list all):
    10a. Savings withdrawals ____________
    10b. To other account (indicate account): ________________ ____________
    10c. To other account (indicate account): ________________ ____________
11. **Total Transfers Out** (lines 10a – 10c) ____________

Other Costs and Revenue

12. Cost of Capital – Paid (include interest paid on savings deposits) ____________
13. Bank Charges ____________
14. Other Costs (list): ______________________________ ____________
15. Other Revenue (list): ______________________________ ____________
16. Ending Cash Balance (next month's beginning balance) ____________
    (line 1 plus line 7 plus line 9 minus line 11 minus lines 12 – 14 plus line 15)

Monthly Bank Reconciliation Form

NGO: ______________________________
Bank: ______________________________
Month/Year: ______________________________
Name of Account: ______________________________
Account Number: ______________________________
Person Preparing Reconciliation: ______________________________
Preparation Date: ______________________________

A. Ending Balance per Bank Statement ____________

B. Add: Total Deposits in Transit (from schedule 1, below) ____________

C. Less: Total Checks Outstanding (from schedule 1, below) ____________

D. Ending Reconciled Balance (A plus B minus C = D) ____________

E. Ending Balance per Checkbook and Report ____________

F. Variance (should be zero) (D minus E = F) ____________

Schedule 1

Deposits in Transit		**Checks Outstanding**	
Date/Number	Amount	Date/Number	Amount
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
________	________	________	________
Total	________	Total	________

Loan Aging Report

NGO: ______________________________

Product: ______________________________

Reporting period (month/year): ____________________

Preparer: ______________________________

No. Days Late	Balance of Loans in Arrears	Provision (%)	Provision for Loan Loss Reserve
1 – 30	____________	10%	____________
31 – 60	____________	50%	____________
61 – 90	____________	75%	____________
91 – 120	____________	85%	____________
121 – 180	____________	100%	____________
Total	____________		____________

Loan Loss Reserve at End of Prior Period: ______________________________

Current Charge: ______________________________

Monthly Loan/Savings Activity Summary

NGO: ____________________

Loan Product: ____________________

Preparer: ____________________

Month/Year: ____________________

Beginning Balances			Current Month Activity			End of Month Balances								
ID No.	Date of Disburse-ment	Principal Out-standing	Principal Repaid	Interest/ Penalties Paid	New Loans Dis-bursed	Principal Out-standing	Principal in Arrears	Principal at Risk	Interest Owed	Final Instal-ment Due Date	Total Savings	Length of Loan Term	No. of Clients: Total/ Women	No. of Bor-rowers: Total/ Women

Monthly Arrears Report

NGO: ____________________

Preparer: ____________________

Month/Year: ____________________

Borrower ID No.	Credit Officer Responsible	Loan Product	Principal in Arrears	Number of Days in Arrears	Principal at Risk	Date of Disbursement	Final Installment Due Date	Actions Taken

Monthly Disbursement Report

NGO: ______________________________

Preparer: ____________________________

Month/Year: __________________________

Borrower ID No.	Date of Disbursement	Amount of Loan Disbursed	Repayment Schedule (Amount Due By Month)			
			Month	Principal Due	Interest Due	Total Due

LOANS/SAVINGS LEDGER

Name of Group: ______________________________
ID No.: ______________________________
Number of Group Members: ______________________________
Number of Women Members: ______________________________
Number of Group Members with Loans: ______________________________
Loan Amount: ______________________________
Interest Due: ______________________________
Date of Disbursement: ______________________________
Loan Product/Loan Term: ______________________________

Installment Due Date (1)	Amount Due – This Installment (2)			Previous Amount in Arrears (3)			Total Amount Due (4)			Total Amount Paid (5)			Prepay-ments (6)			Total Paid to Date (7)			Amount in Arrears (8)			Amount Outstanding (9)			Dues Paid (10)	Savings (11)		
	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total		Dep.	With.	Total

Notes:
Column 4 = column 2 plus column 3
Column 7 = column 4 minus column 5
Column 8 = Total initial principal and interest minus total amounts from column 7
Column 5 (Total amount paid) includes amount in column 6 (Prepayments)

APPENDIX IV: RECORD OF THE PROCEEDINGS OF THE TRAINING WORKSHOP

Workshop on Improving the Effectiveness of Micro-Finance Operations

Participants: The Micro-Finance NGO Partners of Parters for Development

DAY ONE: MONDAY, JULY 1, 2002

1. **OPENING FORMALITIES**
   The Workshop was declared open at 9.00 A.M. by the Acting Country Programme Director, Mr. Ian de la Rosa. An opening prayer was said by Miss Nelly Ogenyi of HADO Development Services, Otukpo.

2. **INTRODUCTION OF PARTICIPANTS**: The Consultant, Mark Gizzi, facilitated the process of the introduction of the participants. He organized them into pairs; they then introduced each other by announcing to the group their partner's name, organization, job title, something unusual about the person, and what she/he would like to be called during the workshop.

3. **WORKSHOP SCHEDULE:** The participants agreed to the following times for the workshop:
   - **Daily sessions:** 8:30 A.M. - 4:30 P.M.
   - **Tea Break:** 10:30 A.M - 10:40 A.M.
   - **Lunch:** 1:30 P.M. - 2:15 P.M.

4. **EXPECTATIONS OF THE PARTICIPANTS:**
   Participants were asked to form groups with the other members of their NGOs and to write down their expectations for the workshop. They were asked to prioritize these expectations and to write down on a green card what they considered to be their highest priority. The group representatives then presented these expectations to the larger group:

   - Develop a strategy to improve loan recovery.
   - Develop a strategy for the organization's sustainability.
   - Learn how to improve the repayment rate.
   - Learn how to improve performance.
   - Acquire more skills to improve current practices.
   - Acquire basic knowledge and skills to correct our errors and improve operations.
   - Acquire more knowledge and skills to improve our mode of operation.
   - Develop a basic long-term plan/budget for the organization.
   - Review the pricing formula for setting interest rates.
   - Develop a method for recovering late loans.
   - Learn important indicators to help evaluate micro-credit activities.
   - Acquire information on how to operate a micro-credit program.
   - Learn how to calculate repayment rate and portfolio at risk ratio.
   - Learn how to make accurate entries into the cash analysis book.
   - Learn how to develop the small enterprises of our existing groups.

5. **WORKSHOP OBJECTIVES**

The facilitator, Mark Gizzi, presented the specific objectives of the workshop in a flipchart as follows:

By the end of the training, the participants will have:

(1) Reviewed micro-finance best practices and compared them with their organizations' current policies.
(2) Understood the causes and costs of loan delinquency.
(3) Learned how to better manage delinquency and improve repayment.
(4) Reviewed the key elements of a balance sheet, income statement, and portfolio report.
(5) Utilized the information contained in financial and portfolio reports to calculate key financial ratios.
(6) Understood how to use key financial ratios to effectively manage and monitor a credit program;
(7) Reviewed the definitions of key financial terms.
(8) Reviewed suggested revisions to their organizations' information (monitoring/reporting) systems.
(9) Developed basic long-term plans/budgets and projections for their organizations' micro-finance programs.
(10) Reviewed the pricing formula for setting interest rates.
(11) Used the pricing formula to determine an appropriate effective rate for their organizations' loan products.
(12) Determined if their organizations are charging an appropriate nominal interest rate.
(13) Discussed how to strengthen the pre-loan training of borrowers.

6. GOAL/OBJECTIVES OF NGOs' MICRO-CREDIT PROGRAMMES:

Participants were again asked to form groups with the other members of their NGOs and to write down the objectives of their micro-credit activities. They were told to answer, in one sentence, the question: "What are your organization's objectives with regard to your micro-finance activities?"

6.1 PRESENTATION BY PARTICIPANTS:

The NGOs (OTIA, HADSERVS, OCAG, ADDS, OSA, Methodists, HADO, and WIN) presented their responses to the entire group:

OTIA DEVELOPMENT FOUNDATION

- To empower poor women to generate additional income through the micro-credit scheme.
- To review and develop a more sustainable approach for micro-credit within the organization.

HADSERVS:

- To empower the rural and urban poor through access to micro-credit facilities for a better standard of living.

OGAG:

- To provide access to and control of information and resources to our women and youth through micro-credit activities.

ADDS

- To improve the standard of living of the less privileged people in the rural and urban areas of Benue State.

- To give people access to financial resources to carry out income-generating activities.
- To improve the financial situation and economy of less privileged rural people.

OSA FOUNDATION

- To boost the capital of the entrepreneurial poor in order to improve their incomes. This enhances their standard of living.

METHODISTS:

- To alleviate the poverty of widows and less privileged women.

HADO:

- To promote at all times the general welfare of rural women, men and youth.
- To initiate, develop, implement and evaluate programs that will improve the living standards of women, men and youth through the micro-credit scheme.

WIN

- To alleviate poverty among underprivileged women.
- To improve the financial status of women.
- To build women's capacity in various areas.
- To ensure the self-reliance and sustainability of women.

Mark:
The facilitator remarked that every single one of the NGOs mentioned social objectives (related to empowering and improving the living standards of poor people), but only one or two NGOs mentioned objectives related to the financial viability of their organizations. He said that micro-finance programmes actually have to ensure the financial sustainability or their organizations if they want to have significant social impact.

Further comments by the facilitator: NGOs that offer micro-finance services have to think about what is called their **Double Bottom Line**. The "bottom line" generally refers to the level of profitability of a business. But micro-finance NGOs like the ones represented at this workshop have a double bottom line. They must not only ensure that they are achieving their social impact goals, but also that they are generating sufficient revenue from their micro-finance activities to cover their costs. In order to achieve significant and long-term social impact, they must achieve financial sustainability. It is not enough to be financially viable (profitable), but at the same time it is not sufficient to focus exclusively on social goals. The NGOs must strike a balance between social impact and financial viability goals.

7. SESSION ON NGOs AS MICRO FINANCE INSTITUTIONS.

The facilitator passed out Handout 1 (below) and addressed the advantages and challenges of NGOs as providers of micro-finance services.

Comments on the presentation: You have to find a balance between your social goals and your financial goals. If you forget your financial goals your programme will not achieve long-term viability and your activities will have little impact. If you don't provide your services in a business-like way, your programme will fail. If you provide your micro-finance services in a business-like way, you will be able to continue providing services in the future and you will be able to reach more people; if you do not act in a business-like way, you will have repayment problems, which will decrease your income, put your capital at risk, and threaten the long-term viability of your institution.

On item 3 under challenges, it was emphasized that the NGOs should think of themselves as providing services to clients, not beneficiaries. In order to be successful, they need to think of themselves primarily as businesses with social goals, rather than as social service or charitable organizations.

HANDOUT 1

NGOs AS MICRO-FINANCE INSTITUTIONS

Advantages:

1) Clear commitment to work with poor people;

2) Familiar with household livelihood strategies and the financial situation of the target population;

3) Well-established in local communities with good access to the population.

Challenges:

1) As social assistance organizations, few NGOs possess a business culture;

2) Few possess professional expertise in financial management;

3) NGOs must alter their public image (instead of serving "beneficiaries," must establish contractual relationships with clients).

8. SESSION: MICROFINANCE BEST PRACTICES (see handout 2, attached) :

In introducing the session, the facilitator said that micro-finance best practices are practices that micro-finance institutions have demonstrated through experience to be effective in reducing costs and managing risks.

The points contained in the handout were reviewed and discussed together.

The handout is made up of five sections: Loan products and lending policies; productivity of credit officers; group versus individual lending; target clientele; and management information system.

LOAN PRODUCTS AND LENDING PROCEDURES

Comments in this area included the following:

- Organizations (especially inexperienced organizations) should provide just a few standardized loan products that meet the needs of the majority of potential clients. Offering too many loan products complicates the management of the loan portfolio.
- In general, short- term loans are less risky (in terms of repayment) than long-term loans.

- First-time borrowers are not well known to the organization, so the organization should start conservatively with small loans to such borrowers. Offering the possibility of progressively higher loans immediately after on-time repayment motivates borrowers to repay.
- Why is frequent repayment important? Frequent repayments give the organization the opportunity to monitor repayments on a regular basis and immediately address any problems that arise.
- If borrowers who have good repayment records have to wait a long time (more than one or two weeks) between the final installment payment and the disbursement of the next loan, it could negatively affect their businesses – and it also discourages them. Reward borrowers who have good repayment records with repeat loans almost automatically. This will motivate them to repay on time.
- Match the loan term to the business cycle of the borrower. Example used:

Borrower:	Dressmaker
Business cycle:	4 months – she buys a lot of cloth and other supplies (for N10,000) at the beginning of the period to benefit from bulk purchasing; she sells her dresses over a 4-month period.
Loan needed:	N10,000
Interest Rate:	3% month.
Revenue:	N16,000 over 4 months (N4,000 per month).

Period	Business	Loan	Net Income
0	(N10,00)	N10,000	-
1	N4,000	(N2,800)	N1,200
2	N4,000	(N2,800)	N1,200
3	N4,000	(N2,800)	N1,200
4	N4,000	(N2,800)	N1,200
TOTAL	**N6,000**	**(N1,200)**	**N4,800**

It was concluded that the loan term (4 months) matches her business cycle because she was able to earn more than enough during each installment period to cover her monthly payments of principal and interest.

Question: What about fluctuation in revenue over the course of the business cycle?
One must consider total household income and cash flow to determine if the borrower will be able to repay. In any case, one must strike a balance between standardization and the individualization of loans to meet borrowers' business cycles. When designing your loan product, determine what would meet the needs of the majority of potential clients.

Example where the loan term (6 months) does not match the dressmaker's business cycle:

Period	Business	Loan	Net income
0	(10,000)	10,000	-
1	4,000	(1,967)	2,033
2	4,000	(1,967)	2,033
3	4,000	(1,967)	2,033
4	4,000	(1,967)	2,033
5	0	(1,966)	(1,966)
6	0	(1,966)	(1,966)
Total	**6,000**	**(1,800)**	**4,200**

It was noted that unless she had saved money during the first four months, it would be would be difficult for the dressmaker to pay the last two installments of the loan. A contributor to the discussion also said that it would be advisable to encourage the borrowers to pay as much as they can (more than was scheduled if they have it) so that they will not spend the money and will be able to repay the loan on time.

Concerning point 8, the facilitator indicated that the mutual guarantee – or joint liability guarantee – is the most effective collateral substitute. The NGOs should emphasize the importance of this concept during pre-loan training. The facilitator also discussed the optimal size of the mutual guarantee group: 4 to 6 members. He said that a larger group of up to 35 could meet together, but that it should be made up of smaller solidarity groups. To provide an effective guarantee, all of the members of the mutual guarantee group must know one another very well, trust each other, and be willing to help each other.

Question: What if a member dies and the group gets tired of paying for the deceased member? It was made clear that you have to make the group aware of their responsibilities during the pre-loan training; the NGOs' policies have to be clear to the staff and the clients. The clients must agree to the conditions stated by the NGO prior to the disbursement of the loans. Ultimately, it is the responsibility of the group, working with the deceased member's family, to repay the loan.

Concerning point 10: On charging interest rates that are higher than those of commercial banks, it was noted that the costs of providing micro-finance services are higher than the costs associated with traditional commercial loans. At the same time, it was noted that if you charge rates that are lower than the rates that banks charge, your products will probably attract better-off clients and poorer clients will be left out. It was agreed that there is no standard interest rate that can be applied across organizations; interest rates should be based, in part, on the costs incurred by a mature micro-finance institution to deliver specific loan products. (Lending in rural areas, for example, is generally more expensive than lending in urban areas).

PRODUCTIVITY OF CREDIT OFFICERS

Concerning point 1: Each credit officer is expected to work with a fairly large number of borrowers. Credit officers are the key to the success of an organization that offers micro-finance services, since they are the ones who have regular, direct contact with the clients. They meet regularly with the groups, disburse loans, monitor repayment, collect and transport repayments and savings, and ensure that record keeping at the group level is accurate and up to date. In a typical micro-finance institution, a credit officer can manage 200 to 300 borrowers (a credit officer in an urban area would probably be able to handle more clients than a credit officer operating in a rural area).

Concerning point 3: There has to be frequent contact with the groups in order to ensure effective monitoring of loan repayment.

GROUP VERSUS INDIVIDUAL LENDING

Concerning point 1: Making the borrowers partly responsible for loan analysis and approval, loan monitoring, and loan repayment enforcement can help to reduce costs. It can also help to strengthen the mutual guarantee.

Concerning point 3: One challenge related to group lending is that it is less flexible – all members of the group have the same loan terms and the same repayment schedule.

TARGET CLIENTELE

Concerning point 1: Experience demonstrates that clients who engage in activities that have high turnover and that generate regular, steady income have high repayment rates; they have no problem repaying loans in frequent installments.

Concerning point 2: The recommendation is not to abandon rural areas, but to understand that costs are generally higher in rural areas and it is generally easier to work in urban areas. One of the participants pointed out, however, that the mutual guarantee system usually works better in rural areas, because there is more social cohesion in rural communities.

Concerning point 3: The better repayment performance of women has been demonstrated through experience.

MANAGEMENT INFORMATION SYSTEM

Management of micro-finance activities requires good, accurate, and timely information.

CHALLENGES ASSOCIATED WITH AGRICULTURAL LENDING

Concerning point 2: Farming loans require a lot of knowledge on the part of the lender about the rural farm economy and about borrowers' specific farming activities. Lenders should be aware of the risks associated with agricultural loans. Remember that trading loans provided to rural clients can also have very positive impacts on rural households.

Concerning point 3: For the joint liability mechanism to work effectively with farmers, the groups must be smaller. Risks are high if all of the members of the group plant the same crop; if there were an external problem, it would affect all of the members at the same time.

Concerning point 7: Cash flow management is important for all micro-finance institutions. It is particularly important and challenging for organizations that provide farming loans.

Group work

The participants were asked to get into their NGO groups and discuss these micro-finance best practices – and write down how their current products, policies, and practices should be revised to make them more consistent with these sound principles, in order to improve operations (improve repayment and reduce costs).

Presentations by the NGOs

1. **ADDS – Joel**
   To facilitate loan repayment and increase income:
   (1) Disburse new loans quickly to borrowers who have successfully completed their loan term.
   (2) Improve the information system (including adding the repayment schedule and interest rate on the loan agreement; developing a loan repayment tracking form).

2. **OTIA Development Foundation – Vicky**
   (1) Incorporate strategies to reduce costs and manage risks.

(2) Review ODF's loan term policy in order to focus on short-term (8-month) working capital loans.
(3) Provide adequate and effective transport facilities, supplies and other motivation to the credit officers, to increase their productivity.
(4) Review ODF's lending policies and try to concentrate more on traders and less on farmers.

3. **OCAG - OBB**

(1) Review our l3 and 6 month loan products.
(2) Apply the double bottom line (i.e., emphasize both asocial impact and financial viability).
(3) Provide loans only to clients who we are sure will pay back within the loan term (creditworthiness).
(4) Strictly adhere to weekly and/or monthly installment repayments.
(5) Give automatic loans to borrowers with good repayment records.
(6) Study the cash patterns of borrowers and the purpose of their loans.
(7) Improve the mutual guarantee system as a collateral substitute.
(8) Gather information from local networks in our borrowers' communities to ascertain their creditworthiness.
(9) Ensure that credit officers have sufficient resources and motivation to do their jobs effectively.
(10) Ensure adequate supervision of the credit officers.
(11) Improve our monitoring of loan repayment and group activities.
(12) Encourage more group lending, rather than individual lending.
(13) Encourage collective responsibility of group members to ensure loan repayments.
(14) Focus on urban and peri-urban dwellers for loans.
(15) Keep accurate and timely records for good operational management.

4. **WIN-Kate**

(1) Do not disburse a new loan to any group if one of its members still has any amount in arrears.
(2) Do not make any disbursements between October and December (due to season and festivities); this is based on WIN's own experience. This is one of WIN's policies.
(3) Force clients to present their relatives and/or spouses as guarantors, in case of death, during the pre-loan training. This is one of WIN's policies.
(4) Ensure that group members are engaged in trading activities.
(5) Carry out a survey to really know the creditworthiness of group leaders and members.
(6) Use savings to repay the loan if it becomes obvious that the borrower is not paying.

5. **OSA- Simon Agande**

(1) Provide both group and individual loan products.
(2) Offer the following loan terms: 4 months for trading loans
9 months for farming loans
(3) Require weekly or fortnightly installment repayments.
(5) Reward prompt loan repayment with new loans quickly.
(6) Make sure that the loan size is consistent with business size, business type and peak period.
(7) Use the joint liability system and the surety of one person outside the loan group as guarantees.
(8) Increase the interest rate from 2.5% month to 3%/month.
(9) Increase the number of credit staff for maximum productivity (maintain 250 borrowers/staff.).

(10) Provide at least one motorcycle for each area office.
(11) Make available individual lending products only to group members who have, over time, achieved excellent repayment records.
(12) Keep a separate credit fund for farming loans.

6. **Methodist Women - Tony**
(1) Reduce the loan term for first-time clients to 6 months.
(2) Require weekly loan repayment.
(3) Gather reliable information on potential borrowers before the loans are approved.
(4) Reward borrowers with good repayment records.
(5) Provide sufficient resources, such as transportation, to the credit officer to enable her to effectively carry out her job.

7. **HADO - Nelly**
(1) Review our policies and procedures with our clients.
(2) Encourage quick repeat loans to those groups who repay on time.
(3) Match loan terms to borrowers' business cycles.
(4) Improve lending procedures and group formation.
(5) Provide training to borrowers before loans are disbursed.
(6) Inform clients that delinquency and default is a virus in a micro-credit scheme.

8. **HADSERVS- Shaapera**
(1) Provide more standardized loan products to clients.
(2) Provide small loans to first-time clients.
(3) Provide short-term loans; they are easily managed.
(4) Emphasize the business/client relationship with borrowers, rather than focusing on charitable goals.
(5) Network with local communities to learn more about potential borrowers.
(6) Promote group lending rather than individual lending.
(7) Reduce the number of farming loans given.
(8) Closely monitor loan repayment, group leadership, group cohesion and group record keeping; credit officers are primarily responsible for this monitoring.

Comment:
Moses: WIN should review their policy of not providing loans after October; for some borrowers, the holiday season is an excellent time to do business.

Mark's Recommendations to the NGOs Related to Best Practices:

1. Offer one or at most two loan products and manage them well.

2. Ensure that loan conditions/terms are as simple as possible and clear to both staff and borrowers. Ensure that they are consistent with the organization's documented policies.

3. Decentralize decision-making with regard to loan analysis and approval. Responsibility should be given to the groups and the loan officers. Training should be provided to the groups so they are able to do the analysis; training should be provided to the loan officers so they are able to monitor and assess the group's analysis. If you make the groups responsible, it will reinforce the group guarantee mechanism and also reduce the administrative burden at the level of the NGO.

4. Start with small loans and gradually increase the maximum loan size for each subsequent stage. It will help to motivate on-time repayment if subsequent loans are disbursed without too much delay.

5. Keep loan terms short and repayment very frequent (every 1 - 2 weeks).

6. Strongly emphasize the mutual guarantee (cross-guarantee) system at the pre-loan training (making the members understand what their responsibilities are) and at each subsequent encounter with the groups

7. Ensure that credit officers have sufficient resources to do their jobs effectively and get to the meetings of their clients on time, are sufficiently motivated, and are adequately supervised. The credit officer must be able to meet regularly with borrowers.

8. Think twice about farming loans. Think about the risks and about all the information you must have to effectively manage agricultural loan products.

9. Work with groups rather than individuals whenever possible. It is more cost effective and the mutual guarantee mechanism is more effective than the use of guarantors as a collateral substitute.

10. Maintain close contact with your clients. The more contact you have with them the more you will understand their businesses and the sooner you will be able to detect and resolve problems.

11. Review your savings policies. It is fine to use a small amount of mandatory savings as a token of collateral, but I would not recommend blocking more than 5% of the value of the loan. Requiring more mandatory savings would discourage poorer people from participating and could disrupt the cash flow of borrowers. To encourage clients to save, I would recommend allowing them to withdraw any amount of savings above the mandatory minimum at any group meeting. I would not recommend blocking all savings until a client quits the program; such a policy would actually encourage your best, most mature clients to leave the program. Because you are working with the poor, you cannot rely on savings as a major form of collateral. Instead, you must strengthen the joint liability mechanism.

12. If interest is collected up front, ensure that the borrower has sufficient principal remaining to meet his/her cash flow needs.

AFTERNOON SESSION:

After lunch a short drama was presented to demonstrate some of the best practices of micro-finance.
Lessons from the drama:

- Before the loan is granted, conduct a proper assessment of the potential borrower: trade, size of business, etc.
- Provide follow-up loans only to borrowers who are members of groups that have finished repaying their loans.
- Permit clients to withdraw savings above the mandatory minimum – provided that they are not late on any of their repayments.
- Strengthen the collateral substitutes, especially group solidarity (cross guarantee) and sureties.

Mark then asked the participants for comments on the recommendations related to best practices that he had presented prior to lunch.

(1) Laure: NGOs that have several donors might be forced to offer more than one or two loan products.
Mark: Managing several loan products at the same time requires a great deal of management capacity. It can be done, but I would recommend that NGOs like yours focus on one or two products.

(2) Farmers actually need farming loans -- so what do we do?
Mark: I know that there is a demand and a need for agricultural loans. However, I want you to be aware of the considerable risks involved in agricultural lending, especially for your NGOs. I would not encourage you to make a lot of farming loans if you want to improve your repayment rates.

SESSION: MEASURING PORTFOLIO QUALITY

Mark introduced this session by asking the following questions:

What is the most important asset for an institution that provides micro-credit?

Laure said she thought that the clients are the most important asset. Mark said that he was thinking of specific assets that appear on the balance sheet. OBB then came up with the correct answer: the loan fund (loan portfolio) – that is why it is important to protect it.

What does portfolio quality refer to?

First, it was necessary to define "loan portfolio." This term refers to all principal owed to the organization by borrowers (both current and late loans); the total amount of principal outstanding.

One of the participants stated that "portfolio quality" means essentially the repayment situation.

Mark then asked the participants to brainstorm the terms we use to refer to late loan payments. The participants came up with the following responses:

- Late loans;
- Loans in arrears;
- Loans past due;
- Loans overdue;
- Delinquent loans.

All of these terms mean the same thing. Some participants thought the term "defaulted loans" was also synonymous with these other terms. However, "default" generally refers to a loan that is not expected to be recovered (and has therefore been written off).

Mark asked the participants what information they need to monitor the quality of their loan portfolios. One participant said that they needed to know the repayment rate. Mark then introduced the concept of delinquency by presenting the amount of overdue loans for two different portfolios:

	West	East
Amount of late loans	100,000	400,000

Which portfolio seems healthier? Some participants said West. However, it is impossible to say if one does not know the total amount of loans outstanding:

	West	East
Amount of late loans	100,000	400,000
Amount of loans outstanding	500,000	4,000,000
Late loans as % of loans outstanding	20%	10%

The ratio (late loans as a percentage of loans outstanding) is much more meaningful than knowing only the amount of late loans (a single piece of information).

Group Exercise:
The participants were divided into groups of two to identify ways to measure the quality of a loan portfolio. Participants' ideas:

- Portfolio at risk;
- Repayment rate;
- Age of arrears;
- Repayment rate by loan product;
- Group cohesion

Concerning the last point, group cohesion does have an impact on repayment, but it is not really a measure of portfolio quality.

The repayment – or collection – rate (which we define as the amount of principal, excluding prepayments, collected during the period, divided by the amount of principal expected, including all late loans, during the period) is not one of the ratios used to measure current portfolio quality. It does not indicate the quality of the existing loan portfolio but measures, instead, the rate of loan recovery. It does not indicate the degree of **current** risk in the portfolio. If calculated correctly, the repayment or collection rate is a good measure of repayment performance over time. In short, the repayment or collection rate measures historical activity, not current quality.

Mark then presented two ratios that measure current portfolio quality, by providing a snapshot of portfolio quality at a given point in time:

Portfolio in Arrears

$$\frac{\text{Payments in Arrears}}{\text{Value of Loans Outstanding}}$$

Portfolio in arrears is a ratio that measures the amount of loan principal that is due to be received but has not yet been received against the outstanding portfolio.

Portfolio at Risk

$$\frac{\text{Balance of Loans in Arrears}}{\text{Value of Loans Outstanding}}$$

Portfolio at risk is a more conservative formula, because it places the entire amount of the loan outstanding, if any part of the loan is late, in the numerator. This ratio reflects the true risk of delinquency because even if the amount of payments in arrears is small, the full amount of the loan is at risk (i.e., the portfolio at risk ratio shows current as well as future risk).

The following example illustrates the difference between "payments in arrears" and "balance of loans in arrears."

Amount:	N10,000
Loan term:	4 months
Frequency of repayments:	Monthly
Interest rate:	3%/month
Date of disbursement:	1 July 2002

<u>Date</u>	<u>Amount Due (P + I)</u>	<u>Amount Paid (P + I)</u>
1 July	-	-
1 August	2,500 + 300	2,500 + 300
1 September	2,500 + 300	2,500 +300
1 October	2,500 + 300	0

As of 2 October, there is N2,500 in arrears. However, the total amount of principal outstanding (N5,000) is at risk.

<u>Group exercise:</u>

Mark asked the participants to work in small groups to do the calculations and answer the questions as instructed on Handout 3:

1. Using the Sample Portfolio Report, calculate, for both 1994 and 1995:
    A. Portfolio in Arrears ratio
    B. Portfolio at Risk ratio

2. Assume that in the last month of 1995, the 6 loan officers were extremely busy, and each disbursed 30 new loans. What would happen to the Portfolio in Arrears ratio and the Portfolio at Risk ratio? Why?

3. Calculate the Portfolio in Arrears and Portfolio at Risk ratios for the sample portfolio below. What explains the difference between the two ratios in this sample?

Client	Amount Disbursed	Principal Repaid					Principal Outstanding
		Week 1	Week 2	Week 3	Week 4	Week 5	
A	1150	25	25	25	25	25	1025
B	1150	25	25	25	25	25	1025
C	1150	25	0	0	25	25	1075
D	1150	25	0	0	0	25	1100

<u>Correct Answers:</u>

	<u>1994</u>	<u>1995</u>
1a. Portfolio in Arrears Ratio	9,000/70,000 = 12.9%	7,000/84,000 = 8.3%
1b. Portfolio at Risk Ratio	20,000/70,000 = 28.5%	18,000/84,000 = 21.4%

2. Both ratios would decrease because the denominator would increase at a greater rate than the numerator. As a result, the delinquency problem gets hidden.

3. Portfolio in Arrears Ratio: 50 + 75 = 125. 125/4225 = 3%
Portfolio at Risk Ratio: 1075 + 1100 = 2175. 2175/4225 = 51.5%

The large difference between the two ratios is caused by two factors:

a) Small and frequent repayment amounts make the numerator in the portfolio in arrears ratio small;
b) Because the loans are at the beginning of their term, the portion outstanding is large, making the denominator large.

SESSION: THE COSTS, CAUSES AND CONTROL OF DELINQUENCY

Mark asked the participants to brainstorm the costs of delinquency: *How do delinquent loans affect the financial performance of an organization that provides micro-finance services?*

Responses:

- Increased costs to track or follow up on late loans – by both credit officers and managers;
- Risk of attack/accidents;
- Increased management time;
- Delayed income and slower portfolio rotation

Mark added that there would be increased costs related to the provision for late loans. He then presented the following information on a flip chart:

FINANCIAL IMPACT OF DELINQUENCY

Higher Costs

COLLECTION: Credit officers and managers spend more time on it;

LOAN PORTFOLIO ANALYSIS/MANAGEMENT: Managers spend more time on it;

DELAYED INTEREST INCOME: Negative impact on cash;

SLOWER PORTFOLIO ROTATION: Negative impact on cash flow; less interest and fees.

Mark then asked: *What are the non-financial effects that delinquency might have on the organization?*

- Demoralizing
- Frustrating
- Energy sapping
- Opportunity costs
- Reduced efficiency – inability to reach the target population
- Could result in the bankruptcy of the organization

Mark added that the reputation of the organization as a provider of micro-finance services would suffer.

Mark then asked the participants to work in pairs to answer the questions below using the information provided in the following sample portfolio:

COST OF DELINQUENCY – EXERCISE

Client	Loan Amount	Loan Term (Monhs)	Payment (P)	Payment (I)	Payment received (two week periods)					
A	6,000	6	500	60	X	X	X			
B	3,000	3	500	30	X	X	X	X	X	X
C	6,000	6	500	60	X	X		X	X	X
D	3,000	3	500	30	X	X				
E	6,000	6	500	60	X	X	X	X	X	
F	6,000	6	500	60	X	X	X		X	
G	3,000	3	500	30	X	X				
Total	33,000									

QUESTIONS:

(1) After 6 payment periods, how much interest (and principal) should the organization have collected?

<u>Answer</u>: P = 21,000
I = 1,980
Total = 22,980

(2) After 6 payment periods, how much interest (and principal) did the organization actually receive?

<u>Answer</u>: P = 13,500
I = 1,320
Total = 14,820

(3) What percentage of expected revenue has been delayed?

<u>Answer</u>: Interest Delayed: 1,980 – 1,320 = 660
660/1,980 = 33.3%

P and I Delayed: 22,980 – 14,820 = 8,160
8,160/22,980 = 35.5%

(4) How does such delinquency affect the organization's financial position?

<u>Answer</u>: Delayed income and principal due to late payments has a negative impact on cash flow, which can reduce the amount available for lending, which would in turn lead to both slower portfolio growth and a drop in income.

DAY TWO: TUESDAY, JULY 2, 2002

After an opening prayer, the second day of training began with a review of the loan portfolio quality ratios. Mark presented the following information for two micro-finance NGOs, North and South, to illustrate the difference between Portfolio in Arrears Ratio and Portfolio at Risk Ratio:

	North	South
Portfolio	100,000	150,000
Amount past due	10,000	15,000
Portfolio in Arrears Ratio	10,000/100,000 = 10%	15,000/150,000 = 10%
Balance of loans with an amount past due	25,000	25,000
Portfolio at Risk Ratio	25,000/100,000 = 25%	25,000/100,000 = 16.67%

Mark asked the participants why the second formula, Portfolio at Risk Ratio, is a better measure of the portfolio at risk. Answer: When late payments occur, the whole loan balance is at risk, not just the amount that has become due.

Mark then returned to a discussion of the costs of delinquency. He explained that when delinquency becomes default, the organization must consider both lost income and lost principal. He then presented the following information on a flip chart to demonstrate the high cost of default:

CALULATING THE COST OF DEFAULT

Initial loan amount	300,000
Interest rate	15%
Loan term	52 weeks
Weekly payment	6,600
Payment received	17 weeks – 112,200
Payment overdue	35 weeks – 231,000

Lost income:	29,750
Lost principal:	201,250
Total lost income and principal:	231,000
Revenue earned per 300,000 loan over 52 weeks:	45,000

Number of loans required to recover lost principal and income $= \dfrac{\text{Lost principal + interest}}{\text{Revenue per loan}}$

$= \dfrac{231{,}000}{45{,}000}$

= 5 Loans

In this example, the organization would have to make five additional loans of 300,000, and ensure repayment of principal and interest on all of them, to make up for the amount of principal and interest lost (and this does not even take into account the additional operating and financial costs associated with making new loans).

SESSION: CONTROLLING DELINQUENCY

Mark asked the participants to meet in their NGO groups. He asked them to list all the causes of loan delinquency that they could think of and then, based on their own experience, to determine the two or three most important or prevalent causes and write them down on cards.

The NGOs made their presentations to the larger group. Mark then asked the participants to determine whether each of the various causes mentioned by the NGOs were related to external factors, the borrowers themselves, or the methodology/procedures of the NGO. The participants categorized them in the following way:

External Factors
- Non-payment of salaries of state/local government staff.
- Bad market
- Ill health and death

Borrowers
- Loan diversion
- Bad borrowers
- Lack of commitment on the part of clients
- Loan diversion

Methodology/procedures of the NGO
- Improper orientation (training)

Mark noted that only one of the causes of loan delinquency mentioned by the participants was related to the methodology and procedures of the NGO, while most of the causes mentioned were related to "bad" borrowers. He then asked the participants to reflect on the following statement:

"There are no bad borrowers, only bad credit providers."

Handout 4 (attached) on the costs, causes and control of loan delinquency was passed out and read out and discussed by all.

Comments and reaction from the participants:
P. (Uncle Moses)- I want to know where these findings are from. The information in the handout is based on findings from what region? To me the findings are in contrast to what our experiences are in this part of the globe.
F. (Mark) - They are based on experiences from Africa, Asia, and Latin America – and also on my own personal experiences, primarily in West Africa.
P. (Dr. Akuto) - I have a contrary view from the first speaker. I feel the handout mirrors what problems my organization is facing; I concede that most of our problems are related to our structure and methodology.
P. (Uncle Moses) - Civil unrest has affected repayment badly especially for OSA and ADDS. People who took loans lost markets and were compelled to feed more mouths with a lot of displaced people in their

communities. Some have lost their goods completely. Our donors have not appreciated our problems despite our efforts to recover amounts owed. What advice do you have for us?
F. (Mark) – In very rare cases, such as natural disasters (massive flooding in Bangladesh, for example) or civil war, where the entire population is affected, some micro-finance institutions have actually suspended operations during the crises. Once the situation returns to normal, regular operations (including the normal repayment schedules of the borrowers) are resumed. Obviously, suspending operations should be contemplated only very rarely and in extreme situations.

GROUP WORK:
Participants were grouped into their NGOs to develop action plan for controlling and managing loan delinquency and for improving repayment. They presented their action plans as follows:

HADO ACTION PLAN

Activities	Date	By who	Resources need
Improve the system of pre-loan training with our clients	16-21/7/02	Credit officers	Human, time, experience, money
Selection of groups	24/7/02	Credit officers, group leaders, and committee.	

F. What do you mean when you say selection of groups?
David- we will select groups out of the pre-existing groups we work with.
F. It is better to present your products and allow interested clients to do self-selection and self-formation of groups.
P. Is experience a human resource and how do you measure it?
David- yes, it is part of human resource and is measure by experience.

ADDS PLANS TO CARRY OUT THE FOLLOWING POLICIES (CREDIT) AND OPERATIONS.

- Improve savings policy (mandatory).
- Charge interest on late loans.
- Retrain our clients.
- Provide loan forms (for repayment) that would improve management's ability to monitor/analyze loan repayment (reports).
- Hold credit officers responsible for low repayment.
- Disburse loans quickly to borrowers who have completed their loan terms.
- Regularize meeting with the groups.

Date	Activity	Responsibility	Resources needed
8/7/02	Follow up on loan delinquencies	Staff members and project committee	Transport/feeding allowance
15/07/02	Re-organization of groups not properly formed	Credit officer and committee	Transport /feeding allowance
19/07/02	Supervision of business activities of clients	Staff/committee members	Transportation
26/07/02	Re-orientation of clients	Staff	Transportation

5/08/02	Review of loan application and agreement forms. Group summary ledger	Credit officer	

OTIA DEVELOPMENT FOUNDATION
ACTION PLAN TO IMPROVE REPAYMENT/LATE LOAN RECOVERY

Objective	Activities	Person responsible	When	With whom	Where	Expected results
To improve on loan repayment and recovery of late loans	1. Update late loans record	Credit officer	On-going	Coordinator	Office	Accurate late loan record available
	2. Send a warning letters to clients	Credit officer	On-going	Coordinator	Field	Letter received and action taken acknowledged.
	3. Organize and send loan recovery team	Coordinator	On-going	Credit officer	Field	Good repayment
	4. Introduce incentives to encourage clients to repay loan (e.g., the best group loan repayer).	Coordinator	At the end of repay-ment period	Client/organization	Organization premises	Good motivation to enhance good repayment.

OSA NARRATIVE ACTION PLAN TO RDUCE DELINQUENCY

1. Recovery target to be not less than 98%.
2. Credit officers to have regular meetings with borrower groups.
3. Management to set-up monitoring of such meetings with credit officers and borrowers.
4. Extend and improve pre-loan training; make disbursements more timely; conduct visits to follow up on and recover late loans; re-emphasize rewards for prompt payments and punishment for late payments.
5. Screening of borrowers will be done more strictly.
6. After this workshop, a new portfolio information system will be developed for effective loan management.

7. The above plan will be ratified at a meeting of management and staff.

OCAG ACTION PLAN TO IMPROVE REPAYMENT

Objective	Activities	Time	By who	Expected outcome
- To improve loan repayment - To improve staff performance in micro-credit	1. Retraining of beneficiaries on the benefits of timely repayment and mutual guarantee	On-going	Staff trained by PFD and project coordinator	Improved performance of organization on portfolio quality.
	2. Staff retraining on job performance and expectations on repayments			
	3. Impose penalties on overdue loans			
	4. Identify viable groups			
	5. Close monitoring of groups and staff			
	6. Include external guarantors as a prerequisite for access to loan product			
	7. Provision of adequate resources to credit officer			
	8. Review micro-credit to get timely information on portfolio quality.			

HADSERVS

Objectives	Activities	Time frame	By who	Expected outcome
Minimizing delinquency and default	(1) Adoption of 15% delinquency rate as initial target (2)Review of credit policies and operational guidelines (3) Early payment advocacy (4) Develop incentive package for on-time payment (5) Beef up portfolio information system			

METHODISTS

- Retrain our clients for better performance – to be done by the credit officer. Need transport/ feeding allowance.
- Introduce an incentive package to reward on-time repayment (to appreciate and boost the morale of the clients) – to be done by the board.
- Impose penalties on overdue loans (a delinquency levy of N50 is on-going).

General comments:

- Having borrowers at different loan stages in the same group is not recommended (if loan sizes are too disparate, the mutual guarantee system will be less effective, since borrowers with small loans will find it difficult to guarantee borrowers with larger loans).
- The participants agreed that groups should be encouraged to be self-selecting as much as possible.
- If a group has not completely repaid its loan, do not select those members with good repayment records and provide new loans to them, as this will completely undermine the joint liability mechanism. The advantages of group pressure will be lost. All members of the group must be held responsible for the repayment of the entire amount of the loan to the group.

SESSION: INTRODUCTION TO FINANCIAL STATEMENTS AND PORTFOLIO REPORT

Mark asked the participants why an organization needs a financial management system,
Answers:

- To evaluate the financial position of the organization;
- To improve the financial performance of the organization;
- To achieve accountability among staff;
- To improve the accuracy of reporting

What are the components of a financial management system?

1) An information system (including an accounting system) that collects accurate, complete, and timely information;
2) A system of reports that organizes the information so that managers can analyze the information and use it for effective decision-making.

Mark then presented a flip chart with the types of statements and reports that should be included in a financial management system:

Statements/reports

Balance sheet:	Snap shot of financial position.
Income statement:	Revenue and expenses incurred over a specific period of time.
Cash flow statement:	Summarizes the cash flow of the organization over a specific period of time.
Portfolio report:	Summary statement of loans outstanding including an aging report of delinquent loans.

Mark indicated that the participants would be focusing on the balance sheet, income statement, and portfolio report, since these reports contain the information that one needs to calculate all important financial ratios. He then wrote the following on the flip chart:

ASSETS LIABILITIES + NET WORTH

He asked the participants: *Why do we call this the "Balance" Sheet? What elements must balance on a Balance Sheet?*

Answer: All assets of the organization are funded either by borrowed funds (liabilities) or the institution's own funds (equity or net worth or capital). The total amount of assets therefore must equal the total funding sources. The two sides of the Balance Sheet are two views of the same resources of the organization: the organization's uses of funds (assets) on one side and the funding sources for those assets on the other.

On a Balance Sheet: Assets = Liabilities + Net Worth
What organization has = What it has borrowed from external sources + Own capital

The Balance Sheet is a snap shot of the organization's financial position at a specific point in time. Therefore it is "static." All amounts are cumulative since the organization began. The income statement, by comparison, portrays only the events that have occurred between the dates of two balance sheets (i.e., over a period of time).

Mark introduced the following example of Josephine the Dressmaker's business:

- Made dresses on a sewing machine that she rented from a neighbor
- She then decided to buy her own machine in order to expand her business.
  Purchase price of machine = N150, 000
- To purchase the machine, she used:
  50,000 in personal savings
  100,000 in borrowed funds
- After purchasing the machine, the total value of Josephine's "Business" is N150, 000

What should Josephine's balance sheet look like?
Answer:

Assets	=	Liabilities	+	Net Worth
N150,000	=	N1,000		N500

Mark then passed out copies of the sample balance sheet, sample income statement, and sample portfolio report (see Handouts 5 – 7). These statements/reports were reviewed and discussed line by line with the participants.

<u>Questions</u>
P. When is it appropriate to restructure loans?
F. I would strongly discourage the restructuring of loans, as it results in the appearance of a "healthy" portfolio when in fact, restructured loans remain risk. Renegotiating the original terms of a loan should be contemplated only in very rare cases, such as when there is a natural disaster in the area.
P. Do we calculate depreciation on office items like calculators and other small office equipment and furniture?
If the item is not expected to last more than one year you do not, but on furniture, yes.
P. What does one mean by deferred revenue?
F. If you get a grant, for instance, but it is restricted (i.e., you cannot use it until a specified time in the future), it is called deferred revenue.

LOAN LOSS RESERVE AND LOAN LOSS PROVISION

Example:

1995
Aging report

	Loans in Arrears	Amount at risk	Loan loss Reserve (%)	Loan loss reserve (amt.)
1-30 days	200	8,750	10%	875
31-60 days	75	5,000	50%	2,500
61-120 days	60	2,500	75%	1,875
More than 120	25	1,750	100%	1,750
	360			7,000

1996
Aging Report

1-30 days	235	10,500	10%	1,050
31-60 days	85	6,000	50%	3,000
61-120 days	64	2,500	75%	1,875
More than 120	22	1,600	100%	1,600
	406			7,525

The loan loss reserve is the amount set aside to cover future losses of the loan portfolio. The amount needed is determined on the basis of the loan aging report (a percentage is assigned to each category of loans at risk, based on how long the oldest installment is late, and this percentage of the loans at risk must be "reserved"; loans that have been in arrears for a longer period of time are less likely to be recovered). When the Reserve is created (or adjusted) a loan loss expense (referred to as the Provision for Loan Losses) is recorded on the Income Statement as an expense. The amount of loan loss expensed is then recorded on the Balance Sheet as a *negative* asset – Loan Loss Reserve – reducing the net outstanding loan balance. *Actual* loan losses, or write-offs, are reflected on the Balance Sheet only (and not on the Income Statement) as a reduction of the Loan Loss Reserve *and* the Gross Outstanding Loan Balance. The resultant effect is to leave the Net Portfolio on the Balance Sheet unchanged since the Reserve has already been made (and expensed). If the Loan Loss Reserve is too low relative to the value of loans to be written off, then both the Loan Loss Reserve and the Provision for Loan Losses (on the Income Statement) need to be increased.

In the above example, the Loan Loss Reserve at the end of 1995 was 7,000. At the end of 1996, the Loan Aging Report indicates that the organization needs a Loan Loss Reserve of 7,525. Therefore, the Reserve must be adjusted and a Provision for Loan Losses (loan loss expense) of 525 is recorded on the Income Statement. The Loan Loss Provision is equal to the change in the Reserve.

P. What determines the percentages an organization uses in its Loan Aging Report to determine the amount needed in its Loan Loss Reserve?
F. In some countries, the percentages are mandated by law. In general, however, organizations base the percentages on their own or industry experience. The organization should be prudent enough to ensure that potential losses are covered.

SESSION: FINANCIAL RATIOS

Mark passed out Handout 8 (attached) on important financial ratios.

Why use ratios, rather than looking at the raw numbers?

1) A ratio captures a relationship – the relationship of one piece of financial information to another. Using a common denominator as a base allows us to look at disparate sources of information in a more coherent way than would be possible with individual numbers.
2) Ratios enable us to understand change over time in a more meaningful way.
3) Ratios enable an analysis of trends.

Mark reviewed with the participants where (on which financial statement or report) the information needed for the numerator and denominator of each ratio could be found.

Mark asked the participants to work in their NGO groups to calculate the ratios, using the sample financial statements and portfolio report that had already been distributed, for the year 1995.

1. **Operating Self-Sufficiency Ratio**: Shows ability of organization to cover costs of operations with internally generated income. *An **increasing** operational self-sufficiency ratio is positive.*

$$\frac{\text{Financial Income}}{\text{Financial Costs + Operating Costs + Provision for Loan Loss}}$$

$$\frac{21{,}500}{3{,}700 + 14{,}300 + 2{,}500} = 104.9\%$$

2. **Operating Cost Ratio**: Key indicator of efficiency of lending operations. *A **decreasing** operating cost ratio is positive.*

$$\frac{\text{Operating Costs}}{\text{Average Outstanding Loan Portfolio}}$$

$$\frac{14{,}300}{75{,}000} = 19.1\%$$

3. **Cost per Unit of Money Lent**: Indicates efficiency in disbursing loans (in monetary terms). *A **decreasing** cost per unit of money lent is positive.*

$$\frac{\text{Operating Costs}}{\text{Amount of Loans Disbursed}}$$

$$\frac{14{,}300}{160{,}000} = .09$$

4. **Number of Active Borrowers per Credit Officer**: Indicates performance of credit officers and efficiency of methodology. *Generally, an **increasing** number of borrowers per credit officer is positive.*

$$\frac{\text{Number of Active Borrowers}}{\text{Number of Credit Officers}}$$

$$\frac{1{,}800}{6} = 300$$

5. **Portfolio per Credit Officer**: Indicates potential financial productivity of credit officers. *Generally, an **increasing** loan portfolio per credit officer is positive.*

$$\frac{\text{Value of Loans Outstanding}}{\text{Number of Credit Officers}}$$

$$\frac{84{,}000}{6} = 14{,}000$$

6. **Portfolio in Arrears Ratio**: Indicates amount of loan payments past due. *A **decreasing** portfolio in arrears is positive.*

SESSION: REVISIONS TO PFD REPORTS
- **MONTHLY PORTFOLIO REPORT**
- **MONTHLY FINANCIAL REPORT: SUMMARY OF ALL OPERATIONS**

These reporting forms (see Handout 9) were reviewed line by line and the necessary amendments were made.

DAY 3: WEDNESDAY, JULY 3, 2002

SESSION: SUGGESTED REVISIONS TO THE MANAGEMENT INFORMATION SYSTEM AT THE NGO AND GROUP LEVEL

The loan agreement should include all relevant information including the date of disbursement, the amount of the loan, the amount of interest due, a repayment schedule indicating the exact due dates and the exact amounts of principal and interest due at each installment, any penalties/late fees for late installments, etc.

A number of new forms/reports for improved management of micro-finance operations were introduced to the participants; these forms/reports were reviewed in detail (see Handout 9). The use of these forms/reports is not mandatory, but it was strongly recommended that the NGOs consider utilizing them or similar forms/reports.

Loan/Savings Ledger (Amendments and clarifications)

- At the time of disbursement, list the due dates for each repayment installment.
- A column for registration fees could be added if necessary.
- Error noted on form: should be column 8 (not column 7) = column 4 minus column 5.
- Total amount due is the same as total amount expected.
- Column 6 should come before column 5.
- Column 9 = total initial principal and interest minus total amount from column 7.

Monthly Operations Account Summary Form

- Recommended that two separate accounts be kept: one for operations; one for the credit fund.

Statement of Loan Fund Cash Position by Credit Bank Account

P. How do we treat cash that comes in and out without going into the bank?

F. Ideally, all cash that comes into the organization should be banked before it is use for other purposes. However, you can maintain a cash account in the office to record all cash transactions that do not pass through the bank. Remember that only cash that has passed through the credit bank account can be captured on this form. However, you should use separate Monthly Operations Account Summary Forms for each bank account, cash account, and petty cash account that you have for operations.

Monthly Bank Reconciliation Form.

F: What is the purpose/use of bank reconciliation?

P: To track the funds in the bank; it helps to check errors.

F: Yes, it is a form of internal control. It helps to guard against mistakes and fraud.

Example:

A.	Ending balance per bank statement	=	500,000
B.	Deposits in transit	=	0
C.	Checks outstanding	=	50,000
D.	Ending reconciled balance	=	450,000
E.	Ending balance per checkbook/report	=	450,000
F.	Variance (D minus E = F)	=	0

Deposits in transit

Date/Number	Amount

Checks outstanding

Date/Number	Amount
29/06/02	50,000

Notes:

- Checks outstanding are checks that were not cashed by the bank prior to the end of the month.
- Deposits in transit are deposits that were received and recorded by the organization – but not yet deposited in the bank – prior to the end of the month.

MONTHLY LOAN/SAVINGS ACTIVITY SUMMARY

- Designed to give managers a record of loan activity by month.
- Depending on your repayment schedule, some borrowers may not any activity in a given month – but all borrowers with loans outstanding should be listed.
- Designed to give you both a snapshot of the situation at the beginning and the end of the month, as well as activities during the month. It is essentially a summary of the information that is entered into your loans ledger for the month.
- It is not necessary to repeat the date of disbursement every month.
- Final installment due date is the final installment date when the loan term ends.
- Always count payments of interest before considering repayments of principal, if the amount paid for a particular installment is not enough to cover both principal and interest.

LOAN AGING REPORT

Example of a Loan Aging Report - June

No. of Days late	Balance of loans in arrears	Reserve %	Reserve Amount
1-30	45,00	10%	4,500
31-60	100,000	50%	50,000

61-90	60,000	75%	45,000
91-120	20,000	85%	17,000
121-180	10,000	100%	10,000

Total Reserve = 126, 500

If the Reserve at the end of the previous month was 115, 000, it would be necessary to make a provision (expense) of 15,500 in the month of June.

The difference between the reserve from previous month and the reserve required for the current month is what is provisioned for in the current month. This amount is entered in the operational report as an expense for the month.

MONTHLY ARREARS REPORT
(NO COMMENTS)

MONTHLY DISBURSEMENT REPORT:
Entries are by group unless you make individual loans. It is much more manageable if you track your loan records by groups. In most cases, tracking repayments and savings of individuals should be done by the groups, with the assistance of the credit officers. Both group members and credit officers should be trained to keep these records.

SESSION: DETERMINING AN APPROPRIATE INTEREST RATE

Step 1: Develop a long-term plan that indicates the status of micro-finance activities as of the end of 2004 (the date by which subsidies for micro-finance activities will come to an end).

Process:

- Determine what you want the status of the program to be at a given point in the future (in this case, the end of 2004);
  a) Number of clients/borrowers;
  b) Impact on clients/borrowers;
  c) Institutional development of the NGO;
  d) Financial self-sufficiency of the NGO (we will assume the NGO will achieve 100%).
- Determine how the NGO will get from its current status to its status at the end of 2004 (through phases);
- For each phase, list 3 - 4 general objectives.
- For each objective, list activities, the staff member(s) responsible for carrying them out, and the months in which they will occur (timing); the plan will naturally be more detailed for the current year and more vague for future years.

SAMPLE OF LONG-TERM PLANNING FORMAT:

Consolidation Phase – focus on repayment (July 2002-June 2003)	Expansion Phase (July 2003-December 2004)	Program status End 2004
Objectives	Objectives	- Number of Clients/ Number of Borrowers - Client Impact - Geographical coverage - Status of institution

		organization development - Financial self-sufficiency of the organization

Our focus will be the status of your micro-finance activities in 2004.
For each loan product:

1) Determine the amount of loans outstanding at the beginning of 2004 and at the end of 2004 (Number of borrowers x average loan size).
2) What will staffing needs be to manage that many borrowers and that loan portfolio?
3) Based on staffing requirements, what will be total operating costs for 2004?
4) What will be your sources and costs of credit funds in 2004?
5) What are your projected loan losses?

P. Is it realistic to plan when you do not have the needed resources?

- You have to know were you intend to go and then determine how to access the resources to get there. But you have to be realistic; there has to be a balance.
- You have to plan with a reasonable expectation of what you expect in terms of resources.
- You have to have a vision. If you do not get the needed resources you can make adjustments.
- Planning is not an optional issue. Whether you put down something concrete on paper or not you must reflect on it.
- For implementation purposes you have to break the long-term plan into short-term plans.
- All planning is a very positive concept. Therefore, planning should not be regarded as a waste of time on account of the non-availability of resources in the future to execute the plan.

Step 2: Use the information from your planning process in the pricing formula to determine what effective interest rate you should be charging now in order to generate enough revenue in 2004 to cover all costs associated with your micro-finance activities.

THE PRICING FORMULA – DETERMINING AN APPROPRIATE INTEREST RATE

$$R = \frac{OE + LL + CF + K}{1 - LL} - II$$

R = Interest Rate
OE = Operating Expense rate*
LL = Loan loss rate*
CF = Cost of funds rate*
K = Capitalization rate*
II = Investment income rate*

*Expressed as percentage of average outstanding loan portfolio

You determine when you want your program to achieve financial self-sufficiency and based on projected costs at that time, you fix your interest rate.

A. Average Outstanding Loan portfolio

- The average of the beginning and ending balances of the outstanding loan portfolio.
- This is the denominator for the calculation of each component of the pricing formula.

Calculation:

(1) For the year you expect to achieve100% financial self-sufficiency, add the beginning and ending outstanding loan balances.

(2) Divide by 2

Example:

(1)	Beginning outstanding loan balance:		2,000,000
	Ending outstanding loan balance:		8,000,000
		Total	10,000,000
(2)	Divide by 2:		

10,000,000/2 = 5,000,000

The denominator of each of one of the interest rate formula components is the average outstanding loan portfolio.

B. Operating Expenses Rate:

- Total of all operating costs expressed as a percentage of average outstanding loan portfolio.
- All annual operating costs, including depreciation.
- Value of goods/services for which organization is not now paying (in-kind contributions).

Calculation:

(1) Sum all operating expenses

(2) Divide sum by average outstanding loan portfolio

Example:

Personnel	-	350,000
Travel	-	202,400
Training	-	96,800
Communication	-	26,800
Office cost	-	100,794
Inst. Dev.	-	77,000
Other	-	130,010
Depreciation	-	93,333
In kind cont.	-	1,000
Total		1,078,137

$$\frac{1,078,138}{5,000,000} = 0.22$$

OE Rate = 22%

C. Loan Loss Rate

- Annual financial loss due to loans written off as a percentage of average outstanding loan portfolio.
- Use the organization's experience to project the expected loan loss rate (most micro-finance programs project less than 5% loan losses based on micro-finance industry experience).

Example:

Estimate = .02 Or 2% LL Rate

D. Cost of Funds Rate

- Projection of future market cost of funds

Calculation:

(1) Identify projected sources of funds.
(2) Determine percentage that each source will comprise of portfolio.
(3) Calculate proportional amount of average outstanding loans portfolio.
(4) Estimate financial cost of each source.
(5) Calculate the absolute cost of each source.
(6) Total the absolute costs.
(7) Divide costs by average outstanding loan portfolio.

Example:

Sources funds	Percentage of average outstanding loan portfolio	Amount of average outstanding portfolio	Financial cost	Absolute cost
Savings deposits	50%	2,500,000	10%	250,000
Institutional reserves	20%	1,000,000	15%	150,000
Member share capital	10%	500,000	15%	75,000
Bank loan	20%	1,000,000	12%	120,000
Total	100%	5,000,000	-	595,000

595,000/5,000,000 = 0.12 or 12% CF rate

Institutional Reserves – Net worth or equity. There are no costs associated with this source of funds, but the organization has to protect its value against inflation. This ensures that the value of the organization's capital is not eroded. Grants become part of the net worth of the organization; they must be protected against inflation also.

$$\textit{Cost of funds Rate} = \frac{\text{Absolute cost of funds}}{\text{Average outstanding loan portfolio}}$$

E. Capitalization Rate

- The real net profit that the organization decides to target.
- To support long-term growth, a capitalization rate of at least 5 to 15% of the average outstanding loan portfolio is advisable.

F. Investment Income Rate

- Income expected from organizational investments other than the loan portfolio.

Calculation:

(1) Identify the types of investment.
(2) Estimate an investment amount.
(3) Identify the interest rate earned.
(4) Calculate the total income from the investment.
(5) Divide total income by average outstanding loan portfolio.

Example:

Investment type	Estimated Investment Amount	Annual Interest Earned	Total Income from Investment
Time deposits	2,000,000	8%	160,000
Financial investments with other organizations	100,000	7%	7,000
Other investments	400,000	5%	20,000
Total	2,500,000	-	187,000

187,000/5,000,000 = 0.037 or 3.7% II Rate

$$\text{Investment Income Rate} = \frac{\text{Total income from Investments}}{\text{Average outstanding loan portfolio}}$$

P. What do you mean by time deposits

F. Bank accounts that pay interest on deposits that are blocked for a given period of time.

Summary of example calculations components of the pricing formula:

Average loan portfolio	=	5,000,000
Operating expenses rate (OE)	=	.22
Loan loss rate (LL)	=	.02
Cost of funds rate (CF)	=	.12
Capitalization rate (K)	=	.10
Investment income rate (II)	=	.037

Calculate the interest rate for this example using the pricing formula.

Group work:

$$R = \frac{OE + LL + CF + K}{1 - LL} - II$$

$$= \frac{22+ .02 + .12 + .10}{1 - .02} - .037$$

$$= 0.469 - .037$$

$$= \mathbf{0.432}$$

In this example, for this organization, the effective interest rate charged should be 43.2%
The nominal rate is different from the effective rate and is always either lower than or equal to the effective rate.

The participants were then asked to work in their NGO groups – to determine the number of borrowers and the size of the loan portfolio at the beginning and at the end of 2004, and to estimate all costs in 2004. "This exercise will enable you to determine what effective interest rate you should charge so that you will be able to cover all of your costs in 2004.

For the beginning and end of 2004:

1) Number of borrowers
4) Average loan size — Borrowers x Average Loan Size = Amount of Loan Portfolio

For the year:
Number of staff
Budget – Operating costs
Credit funds - Sources?
- Cost?

Loan losses?
Other investments?

If the interest rate is 30% for 44 weeks, what is the annual rate?

Calculation:

$\frac{30}{44} = \frac{x}{52}$ $\frac{1,560}{44} = x$ $35.5\% = x$

P. My interest concerns a micro-credit organization that has just started operations without prior experience. How does it arrive at these projections?

F. Although many of the components, like the loan loss rate, are based on experience, they can also be estimated based on the experience of similar organizations in similar environments.

P. As a new micro-finance institution. what parameters should it use for the loan loss rate?

F. If you are new I would say use 2-4% loan loss. The others you base on local experience.

Group work (in NGO groups): Determine what your effective interest rate should be in order to cover all costs by the end of 2004. This exercise took nearly 2 hours.

OCAG
2004 Projection

	Beginning	Ending
No. of borrowers	400	700
Average Loan Size	5,000	10,000
Loan portfolio	2,000,000	7,000,000
No of staff	2	3
Average loan portfolio	4,500,000	

Sources of credit funds

- Registration	=	50,000
- Savings	=	1,650,000
- Interest income	=	8000,000
- Grants	=	2,000,000
		4,500,000

Cost of Funds

20% of total fund

= 900,000

$$\frac{900{,}000}{4{,}5000{,}000} = 0.2$$

<u>Budget</u>

Personel

Transport

Photocopy

Office supplies

Others

Total 1,261,000

$$\frac{1{,}261{,}000}{4{,}500.000}$$

OE = 0.29

<u>Loan Loss</u>

Amount 180,000

$$= \frac{180{,}000}{4{,}500{,}000}$$

LL = 0.04 or 4%

K = 10%

$$II = \frac{80{,}000}{4{,}500{,}000} = 0.018$$

$$R = \frac{OE + LL + CF + K}{1 - LL} - II$$

OE = 0.29

LL = 0.04

CF = 0.2

K = 0.1

II = 0.02

$$= \frac{0.29 + 0.04 + 0.2 + 0.1}{1 - 0.04} - 0.018$$

$$= \frac{0.63}{0.96} - 0.018$$

$$= 0.0656 - 0.018 = 0.64$$

Effective Interest Rate Needed	=	64%
Nominal Interest Rate Currently Charged	=	40%

HADSERVS

Current situation
July 2002

- Number of clients 150
- Average loan size 10,000
- Loan portfolio 1,500,000
- Number of staff 6
- Total budget 444,000
- Loan loss (rate) 50,000 (0.011)
- Credit funds 4,500,000

2004 Projections

- Number of borrowers 500
- Average loan size 20,000
- Total number of staff 2
- Cost of funds rate .011
- Loan loss rate .10
- Capitalization rate 0.10
- Investment income rate 0.03
- Operating expenses rate .25

$$R = \frac{OE + LL + CF + K}{I\text{-}LL} - II$$

$$= \frac{.25 + .011 + .10 + 0.10}{1\text{-}.011}$$

$$= \frac{0.461}{0.989} \qquad 0.466 - 0.03 = 0.436$$

$$= 43\%$$

From HADSERVS's presentation it was clear that they had not initially understood the planning process for determining future costs – and how those costs were then applied to determine an effective interest rate. At the end of their presentation however, they understood the basic logic.

P. Do we start charging the new interest rate by July?

F. Changing interest rates is a policy decision that must be made by management. However, I would recommend that you conduct this exercise in a more careful and detailed fashion to ensure that your projections are as accurate as possible; I would not recommend that you make policy changes based on what you did here today.

Step 3: Estimate your current effective interest rate to determine if it is in line with the effective interest rate that you should charge to ensure that you will be able to cover all costs by the end of 2004.

ESTIMATING THE EFFECTIVE INTEREST RATE.

$$\text{Effective Rate} = \frac{\text{Amount Paid in Interest and Fees}}{\text{Average Principal Amount Outstanding}}$$

Note:

$$\text{Average Principal Amount Outstanding} = \frac{\text{(Sum of Principal Amounts Outstanding)}}{\text{Number of Payments}}$$

EXAMPLE:

Loan Amount	=	6000
Loan term	=	16 weeks
Frequency of repayment	=	Every 2 weeks
Interest rate	=	12% for 16 weeks (39% per annum)
Fees and Dues	=	280

2 weeks period	Payment	Principal	Interest	Outstanding balance
0	-	-	-	6000
1	840	750	90	5,250
2	840	750	90	4,500
3	840	750	90	3,750
4	840	750	90	3000
5	840	750	90	2,250
6	840	750	90	1,500
7	840	750	90	750
8	840	750	90	0
Total	**6,720**	**6000**	**720**	**27,000**

$$\frac{27{,}000}{8} = 3{,}375$$

$$\frac{720 + 280}{3{,}375} = \frac{1{,}000}{3{,}375} = 29.6\% \text{ per 16 weeks}$$

Or 96.2%/Annum

Group Exercise (in NGO groups):
Take any of your loan products. What is the current nominal interest rate per annum and what is the estimated effective interest rate per annum?

Presentations:

WIN

Loan Amount	=	10,000
Loan term	=	6 months
Frequency of payments	=	Monthly
Interest rate	=	30%/Annum
Fee	=	200

$$\frac{34995}{6} = 5832.5$$

$$\frac{1500 + 200}{5832.5} = \frac{1700}{5832.5} = 29\% \text{ per 6 months}$$

$$\frac{29}{6} = \frac{X}{12}$$

$$\frac{348}{6} = x \qquad 58\% = x$$

METHODISTS

Loan Amount	5000
Long term	6 months
Frequency of payment	monthly
Interest rate	15% for 6 months
Fee and dues	260
Total principal outstanding	17,490

$$\frac{17490}{6} = 2915$$

$$\frac{750 + 260}{2915} = \frac{1010}{2915} = 35\% \text{ for 6 months} = 70\% \text{ per annum}$$

If your current estimated effective interest rate is higher than the effective rate that you calculated using the pricing formula (using estimated costs for 2004), then your current rate is probably in the appropriate range (but it is recommended that you do much more careful, detailed planning/projections before jumping to any conclusions). If you find out that your current interest rate is too low, you should consider raising it.

The interest rate that you calculated using the pricing formula rate is based on assumptions related to size of portfolio and costs. If your assumptions are accurate, then you should ensure that your current estimated effective rate is as high as the rate that you calculated using the pricing formula.

SESSION: PRE-LOAN TRAINING

What will be the objectives of your pre-loan training as an organization, now that you have gone through the 3-day workshop?

Objectives:

- To get maximum repayment of 100%.
- To make clear to clients their roles and obligations.
- To ensure consistency and commitment.
- To acquaint the client on the benefit of timely repayment.
- To acquaint clients with organizational policies and procedures.
- The need to get collateral substitutes (including external guarantors).
- Group formation.
- Interest rate.
- Savings component.
- Loan terms
- Registration.
- Background of the NGO and source of funding.
- Conditions/terms of loans.
- Savings
- Joint Liability/Cross guarantee.
- Roles and Responsibilities of groups.
- Groups leader and their roles.
- Rewards and sanction.
- Group Development
- Training
- By-laws
- Group records
- There should be an introduction stating the NGO's background and source of funding so that the beneficiaries will know from the beginning the terms/conditions of the loans.

F. What should be emphasized under the saving component of the pre-loan training?
Is the issue of payment of interest on savings promised savers by some organizations feasible?
P. If the cost of operational cost is going to be high, it may be difficult to fulfill this promise.
P. It serves as motivation for savings.
P: The savings is revolved at an interest. It will not be too much to pay interest on savings.
P. Payment of interest could be linked to repayment. If the borrower is not delinquent, he/she will get interest.
F. How should we treat the issue of withdrawal of deposits (savings)?
P. We will have a limit to the amount that can be withdrawn, but we will permit the withdrawal of anything above 10% of the value of the loan.
F. Whatever your policy is, make it clear during the pre-loan training.

Role play by participants
Emphasized the importance of the cross-guarantee.
A member (the only male) in a female group was delinquent. He had used the money to marry a new wife. The credit officer was ready to listen to their excuses. The delinquent member on his part was not bothered about the fact that he was unable to meet up his repayment. Emphasizing the cross-guarantee, the other members of the group decided to contribute for the delinquent member.

Lessons/Comments:
- High risk of giving loans to men.
- Every group is likely to have a difficult member.
- There is need for the group to study themselves before choosing its members.
- The credit officer insisted on repayment and the other members had to contribute to pay.

- The technique (role play), if done properly and carefully, can be every effective if it is done in front of the group during the pre-loan training.

P. What if the delinquent member is not present?
F. It all boils down to pre-loan training. It is the duty of the group to organize the group/meeting. If you relent, they will all follow suit.

- Attendance should be mandatory.
- The group dynamic should be emphasized. There should be gender and age balance.
- Mark spoke about the challenges/disadvantages of mixed gender groups.

Cards were given to participants to write the roles/responsibilities of group leaders, members, and group.

Group presentation:

ROLES OF GROUPS, GROUPS MEMBERS, AND GROUP LEADERS

Green card: Groups	**Pink card: Group Members**	**Yellow card: Group Leaders**
To help themselves when one member is late with her payment	Group guaranteeing	To strengthen the members of the group to be committed towards repayment.
Consistency and communication	To form a force which will ensure timely repayment	To go around and collect the money before time
Members should be reliable and encourage each other in paying promptly	Working together as a team	To monitor all the members of the group and make sure she reminds them about the time of the meeting
- Prompt payments - Attendance at meetings - Savings	The group should be made up of responsible and honest members	To act as a supervisor and coordinator
A group member should be very cooperative	Make sure each and every member in the group is responsible	To ensure 100% repayment on time
- Prompt payment of loans/ Savings - Cross guarantee in case of delinquency. - Attend meetings	Each member will know what his or her responsibilities are in the group	To help members pay their money when due
Cross guarantee for one another as a team	The groups should understand themselves very well before coming together	To ensure that the members of the group make their repayments.
Proper utilization of fund raised by the group leader.	Ensure that their group has the best performance	The group leader should be responsible for prompt payment of members and should be able to control members.
To cross guarantee each other	To cooperate with the group	Ensure the collection of total

	leader to ensure prompt payment	loans/saving due and proper recording.
Each and every member has to save and pay accordingly	Group should be people who know each other well and will be able to stand for each other.	Group leaders are not supposed to be too lenient; they should be somebody that is a little bit strict
To be cooperative	- Cross guarantee - Good knowledge of members' strength and weaknesses	To know her responsibility
To be responsible; to contribute and pay for a member who defaults	To attend all meetings	Develop proposal for funding
All members should serve as guarantor to one another to ensure accurate repayment	• Cross guarantee • Eliminate members who are not credit-worthy • Attend meetings	To go around to members for collection of loan repayments
Cooperate in terms of delinquency.	Cross guarantee	Ensure that all members of the group attend meetings to ensure timely repayment
Every member is supposed to be at the meeting and ensure accurate payment	Work as a team to improve their living standards	The group leader should be able to control her group members and collect their amount due before the arrival of the credit officer
Monitor each other	Help enforce pre-loan analysis	- Payments collection - Record keeping - Cross-guarantee
Help stick to established payments date	They should act as a team by making sure they are all present at all meetings	Ensure that members are complying with terms of agreement
Members Cooperating	Making sure that no member is late with payments any month and if one is the others should pay for the member	Help monitor credit given to members
Be responsible for payment as no delinquency is allowed	Cross guarantee members	Coordinate group activities
- Maintain good relationships with other members. - Good followers	Group should be formed by themselves	- Highly organized - Able to control the group members actively.
Should be ready for her payment; no delinquency or default is allowed	- Prompt repayments - Savings - Attendance at meetings - Cross guarantee	To make sure all members pay before the day of repayment
Cross guarantee for each other and ensure that none of the members are late		Organizing

F. Can groups be used to assess and do analysis of and approval of group members before loan is given to them?
P. Most of us are already doing that. Some groups are already playing these roles. But we need to strengthen the process. The groups should be told the basic stages and aspects of loan analysis, how to monitor the trend of market situation.
P. We held a meeting with leaders and it actually assisted them in strengthening the roles/responsibilities of groups.
The NGOs should help the groups develop rules and procedures for the groups.
Rewards and sanctions – They should know the benefits of paying on time.
Record Keeping – Involve groups in keeping records. (A parallel record could be kept in the office for cross-reference, but such duplication is not necessary).
The field officers should ensure that the groups' records are up to date to avoid ugly situations.

P. Some group leaders complain of the lack of transportation. What do we do?
Responses:
P: We do not motivate leaders but we take care of primary group leaders if they have to move from house to house to enhance repayment.
F: When groups come together; you should ensure that the group members come from the same area (they should not need transportation to visit fellow group members).
F. Encourage groups to contribute to a group fund for any administrative expenses.

F: It is the responsibilities of groups to ensure that the group members make their repayment; they should not be paid by the NGO to carry out their obligations.

HANDOUT 2

MICRO-FINANCE BEST PRACTICES

Strategies to Reduce Costs and Manage Risks

Loan Products and Lending Procedures

2. To simplify operations, offer only one or two highly standardized loan products.

3. Focus on short-term working capital loans.

4. Keep loans small, especially to first-time clients, and keep loan terms short (only a few months).

5. Require frequent loan repayment installments (weekly or monthly) to facilitate close monitoring of the borrowers' loan repayment performance. As clients demonstrate creditworthiness over time, the loan duration and loan repayment intervals can be lengthened – and increasingly individualized loan products can be offered.

6. Reward borrowers who have good repayment records with repeat loans (quickly and almost automatically).

7. Base loan sizes on the cash patterns of borrowers. The appropriate loan size is dependent on the purpose of the loan and the ability of the borrower to repay the loan (consider cash flow and associated risks).

8. Match loan terms to borrowers' business cycles.

9. Use loan collateral substitutes – especially the mutual guarantee or joint liability system.

10. Rely on information from local networks to verify the reputation and creditworthiness of new borrowers – and to help enforce loan repayment.

11. Charge interest rates that are higher than those used by conventional formal lenders.

Productivity of Credit Officers

1. Credit officers serve large numbers of clients (typically 200 to 300 borrowers).

2. Credit officers have sufficient resources (transportation, supplies, etc.) and motivation to do their jobs effectively, and are adequately supervised.

3. Credit officers closely monitor loan repayment, group leadership, group cohesion, and group record keeping.

Group versus Individual Lending

1. Group lending is generally less costly, because it is less expensive to administer one large group loan than many small loans to individual borrowers. Also, costs are reduced when

the members of the solidarity groups (or joint liability groups) are partly responsible for borrower screening, loan monitoring, and loan repayment enforcement.

2. Group lending allows the lending institution to employ the mutual guarantee or joint liability system, which builds upon the collective responsibility of group members to ensure loan repayment. Other types of collateral substitutes tend to be less effective.

3. Challenges associated with group lending: a) Group lending offers less flexible loan terms and repayment schedules (all group members receive and repay their loans in the same cycle); b) There is the potential for abuse of power and corruption by a powerful group leader.

Target Clientele

1. Focus on loans to traders and service providers – activities that have a high turnover and generate regular income flows.

2. Loans can be provided profitably to poor clients in rural areas. Nevertheless, urban and peri-urban areas generally provide better environments (better markets and infrastructure) for profitable micro-businesses of the poor. Also, it is usually easier for credit officers to visit clients and monitor repayment in urban and peri-urban areas.

3. Women generally comply better than men with their loan repayment obligations.

Management Information System

Accurate and timely information is crucial for good operational management.

Challenges Associated with Agricultural Lending

1. There are more risks associated with agricultural loans than trading loans. Risks include:
   a) Production and yield risks: Uncertainty due to the unpredictable impact of weather, pests, and diseases on crop production;
   b) Market and price risks: Price uncertainty due to market fluctuations (this is particularly severe where information is lacking and markets are imperfect) and the fact that there is a relatively long period of time between loan disbursement and the realization of farm output;
   c) Risks from changes in domestic and international policies.

   Farm activities have longer and less stable production cycles and often present a marked seasonality in their revenues.

2. The variety in farming activities and farm management makes it unrealistic to use standardized lending products and conditions for agriculture. The need to design individualized loan products that respond to the demands and repayment capacity of farmer-borrowers requires sophisticated knowledge of farming systems, agricultural commodity markets, and rural and farm household economy. Developing individualized loan products increases the lender's costs.

3. Relatively higher costs are associated with agricultural lending. This is due to the dispersed rural location of the clientele, high transportation costs, and high information costs.

4. Agricultural lenders that work with joint liability groups should be aware that group size and group homogeneity have a direct impact on the effectiveness of peer pressure and the mutual guarantee system. In general, farmer-borrower groups need to be smaller than groups of trader-borrowers. There are high covariant risks associated with farmer-borrower groups that are too homogeneous (i.e., many borrowers would be affected by the same external factors at the same time). On the other hand, too much group heterogeneity can give rise to the problem of demand for different loan products, loan sizes, and loan terms between group members.

5. Small farmer-borrowers often have a subsidy mentality, if in the past there were programs that provided agricultural loans at concessional rates. In addition, agricultural lending is usually more politicized than other kinds of lending.

6. Most agricultural loans require long loan terms and infrequent repayments. It is therefore more difficult to monitor repayment before the end of the loan term.

7. Agricultural lenders must have an excellent cash flow (liquidity) management system. They need reliable information on the timing of required loan disbursements and scheduled loan repayments to properly plan and manage their cash requirements. Sufficient funds should be available at the beginning of the planting season, while the high costs of keeping loanable funds idle should be minimized as much as possible.

<u>Source</u>:

Klein, Brigitte, Richard Meyer, Alfred Hannig, Jill Burnett, and Michael Fiebig. 1999. "Better Practices in Agricultural Lending," *Agricultural Finance Revisited*, No. 3, FAO and GTZ, Rome.

HANDOUT 4

The Costs, Causes and Control of Loan Delinquency

The Costs of Loan Delinquency and Loan Losses

The most important asset of any micro-finance institution is its loan portfolio. Late loans increase an institution's collection costs and decrease its financial margin (when a client does not repay a loan on time, the organization does not earn sufficient revenue on the amount lent and there is a delay in the disbursement of new loans). Loans that are written off must be covered by the institution's revenue – a very heavy cost. Most importantly, high delinquency and loan loss rates cause credit programs to lose credibility vis-à-vis their clients and lead to even more serious problems of delinquency that threaten the long-term viability of the institution.

Causes of Delinquency

Until recently, banks and even development practitioners thought that there was a high level of risk associated with poor borrowers, because they: 1) operate in risky environments; 2) do not have experience with formal financial systems; or even 3) that their moral character is questionable. It was thought that the major causes of loan delinquency were:
- Weather;
- Markets;
- The macroeconomic environment;
- Poor business practices on the part of the borrowers;
- Mismanagement of the loans by borrowers.

However, there have been a lot of credit programs for the poor, created since the 1970s, which have demonstrated that these explanations are not accurate. These programs have attained very low portfolio at risk rates (less than 3%) and have demonstrated that repayment depends fundamentally on factors that are within the control of the micro-finance institution:
1) The quality and dependability of the credit services;
2) The communication of the institution's expectations concerning repayment to the clients;
3) The effectiveness of credit management;
4) A close relationship with clients.

Micro-finance institutions are the cause of most repayment problems. Clients are motivated by signals and incentives established by the institution. They respond as rational economic actors, not ignorantly or irresponsibly.

The following causes are almost always exaggerated: the importance of external factors (natural disasters, structural problems within the economy) or cultural factors (ignorance, irresponsibility, immorality). Once a micro-finance institution recognizes the importance of institutional signals on clients' decisions, repayment problems become manageable.

Micro-finance institutions cause repayment problems in the following ways:
1) Frequently, they are not inclined to impose penalties on poor clients if they do not repay. Politically, they think that such sanctions would not be productive or would be impossible to impose. But if clients know that there will be no "punishment" for not repaying, they will not be motivated to repay.
2) Poor credit management by the micro-finance institution contributes to non-repayment by clients. If the organization does not follow up on clients who have late loans due to the fact that the organization does not know that these loans are late, the problem of late loans will increase.

Establishing an effective credit methodology will reduce and perhaps even eliminate these signals/stimulants that the organization generates with regard to non-repayment. Thus, those repayment problems that remain will be truly the difficult cases, related to unforeseen events or business failures on the part of clients. Experience demonstrates to us that these causes of non-repayment represent less than 3% of the value of the loan portfolio in any given year.

Improving the Repayment Rate

One of the easiest tasks in the world is disbursing loans. One of the most difficult tasks is ensuring repayment of those loans.

To ensure that the credit services are sustained, a micro-finance institution must have systems in place to motivate clients to repay on time and to collect from clients who do not want to repay.

A micro-finance institution that wants to improve its repayment rate must:

1) Utilize a management information system that indicates potential problem loans;

2) Utilize a credit methodology that encourages timely repayment. Does the methodology provide the necessary signals/stimulants to clients for timely repayment? Can clients easily calculate the costs (financial and non-financial) for the repayment of loans on time and compare them with the costs associated with making repayments late (or not at all)? If the clients become convinced that it is in their interest to not repay on time, the institution will have a high portfolio at risk. The institution must apply a methodology that provides more benefits and fewer costs to clients who repay on time.

3) Establish an organizational culture that will not tolerate late repayments. This is the most important element – the attitude of the institution. Late repayments must be simply unacceptable. This philosophy must be communicated to the clients before they receive their loans and reinforced at each subsequent encounter.

It is not necessary to spend a lot of resources and time on a technical analysis of the capacity of poor clients to repay. Rather, successful micro-credit programs base their assessment of risk on clients' performance. One starts with small, low-risk loans and increases the amounts progressively as clients demonstrate the capacity and the good will to repay on time.

Successful micro-credit programs:
1) Focus on solidarity groups and apply the mutual guarantee; and
2) Work with community structures.

These programs recognize that the primary incentive for clients to repay on time is the hope of receiving a new loan when they need it. Programs that understand the desire of clients to have a long-term financial relationship with the institution are more effective and successful. They place a great deal of importance on the quality of their credit services. When the procedures are easy, loans are granted on time, and services are provided in a friendly way, poor clients repay regularly and on time in order to maintain access to a service that they value.

The key for a micro-finance institution is to act rapidly when there is a case of non-repayment, especially in a program where the mutual guarantee is utilized. Late loans indicate that there are internal problems within the group. If the institution does not intervene immediately to help the group resolve these problems, they can become impossible to resolve. Programs that use the mutual guarantee methodology should not have a portfolio at risk greater than 5%.

Strategies for Minimizing Delinquency and Default

1. Establish a target level of acceptable delinquency based on a thorough understanding of the costs and effects of delinquency on the organization. Organizations with new credit programs should establish a minimal level that convinces staff that no delinquency is acceptable. Organizations with existing delinquency problems should set realistic but demanding goals for progressively reducing delinquency to an acceptable level.

2. Accept that most delinquency is caused not by bad borrowers, but by organizations that have not implemented an effective credit methodology. Review credit policies and operations and evaluate the extent to which they are consistent with best practices (sound principles and methodology).

3. Create an image and philosophy that consider late payments to be an unacceptable option.

4. Develop borrower selection techniques that weed out borrowers with bad intentions or bad reputations, and make sure that loan sizes and terms do not make repayment difficult.

5. Establish a system that provides both financial and non-financial incentives to encourage on-time repayment.

6. Ensure that, from the borrower's perspective, the benefits of on-time repayment and costs of late repayment far outweigh the benefits of late repayment and costs of on-time repayment.

7. Review the organization's information system. Ensure that it provides information to managers and credit officers which enables them to conduct effective and timely follow up of loans and to manage the loan portfolio efficiently.

8. Hold credit officers accountable for their performance.

9. Develop a portfolio information system that enables management to conduct timely and useful analysis of portfolio quality, determine trends in the portfolio over time, and identify possible causes of delinquency.

10. Establish prudent loan loss reserve and write-off policies that prepare the institutions for such write-offs. Ensure that income and assets are accurately reflected in the financial statements.

Costs and Benefits Perceived by Borrowers

	On-Time Payments	Late or No Payments
BENEFITS	Probability of immediate, larger follow-up loans	Maintain capital (or portion) from loan in business
	Development of positive credit history	Lower expenses if interest payments not made
	Positive reputation among peers	Fewer or no trips to financial institution to make payments (lower transaction costs)
	Access to training, savings and other program services	Lower transaction costs of attending meetings and other requirements of the organization
	Access to advice from credit officers	
	Awards for timely payment	
COSTS	Pay interest and capital of current loan	Late fees for late payments
	Pay time and transportation costs (transaction costs) to make payments	Delay of future loans or loss of access to future loans
	Financial and transaction costs of any future loans	Possible legal action and costs
		Loss of access to other program services
		Hassle of frequent visits by loan officers
		Hassle of pressure from group members (if group loan)
		Negative reputation among peers

Sources:

X Stearns, Katherine, 1991, "Methods for Managing Delinquency," *Tools for Microenterprise Programs: Financial Assistance Section,* GEMINI Project, USAID, Washington, D.C.

X Stearns, Katherine, 1991, "The Hidden Beast: Delinquency in Microenterprise Credit Programs," ACCION Discussion Paper Series, No. 5, Washington, D.C.

Von Pischke, J.D., Jacob Yaron and Rauno M. Zander, 1998, "Why Credit Project Repayment Performance Declines," *Savings and Development, No. 2,* Giordano dell'Amore Foundation, Milan.

HANDOUT 8

Important Financial Ratios

Financial Sustainability Ratios: Ratios that allow you to determine whether the organization has the financial resources needed to continue serving clients in the future.

7. Operating Self-Sufficiency

$$\frac{\text{Financial Income}}{\text{Financial Costs + Operating Costs + Provision for Loan Loss}}$$

Efficiency Ratios: Ratios that allow you to determine if the organization is managing its operations at the lowest cost possible.

8. Operating Cost Ratio

$$\frac{\text{Operating Costs}}{\text{Average Outstanding Loan Portfolio}}$$

9. Cost per Unit of Money Lent

$$\frac{\text{Operating Costs}}{\text{Amount of Loans Disbursed}}$$

Productivity Ratios: Ratios that allow you to determine the productivity of the credit officers, the primary generators of revenue for the organization.

10. Number of Active Borrowers per Credit Officer

$$\frac{\text{Number of Active Borrowers}}{\text{Number of Credit Officers}}$$

11. Portfolio per Credit Officer

$$\frac{\text{Value of Loans Outstanding}}{\text{Number of Credit Officers}}$$

Portfolio Quality Ratios: Ratios that allow you to determine whether the organization is managing its assets well.

12. Portfolio in Arrears

$$\frac{\text{Payments in Arrears}}{\text{Value of Loans Outstanding}}$$

13. Portfolio at Risk

$$\frac{\text{Balance of Loans in Arrears}}{\text{Value of Loans Outstanding}}$$

HANDOUT 9

Monthly Portfolio Report

NGO: ______________________________
Preparer: ____________________________
Month/Year: __________________________

I. General Information

1. Number of clients at the end of the month ____________

2. Number of groups at the end of the month ____________

3. Number of women clients at the end of the month ____________

4. Number of men clients at the end of the month ____________

5. Number of clients withdrawn this month ____________

6. Number of clients died this month ____________

7. Number of groups dissolved this month ____________

8. Number of borrowers with loans outstanding at the end of the month ____________

9. Number of credit officers ____________

II. Loans

10. Number of loans disbursed this month ____________

11. Number of loans disbursed to date ____________

12. Amount of loans disbursed this month ____________

13. Amount of loans disbursed to date ____________

14. Type of loans granted this month:
    - Agriculture ____________
    - Food processing ____________
    - Trading ____________
    - Services ____________
    - Joint venture ____________
    - Other ____________

III. Repayment

15. Total amount of principal (including arrears) due this month ____________

16. Total amount of principal repaid this month ____________

17. Prepayments of principal this month ____________

18. Amount of interest and penalties paid this month ________

19. Amount of loans outstanding at the end of the month ________

20. Amount of principal in arrears at the end of the month ________

21. Number of borrowers (groups) in arrears at the end of the month ________

22. Balance of borrowers (groups) with late loans at the end of the month ________

23. Age of arrears at the end of the month
    a. 1 – 30 days ________
    b. 31 – 60 days ________
    c. 61 – 90 days ________
    d. 91- 120 days ________
    e. 120 – 180 days ________
    f. More than 180 days ________

24. Amount of loans written off this month ________

IV. Savings

25. Number of savers at the end of the month ________

26. Total amount of savings at the end of the month ________

V. Ratios

27. Collection rate this month: (line 16 minus line 17) divided by line 15 ________

28. Portfolio in arrears rate at the end of the month: line 20 divided by line 19 ________

29. Portfolio at risk rate at the end of the month: line 22 divided by line 19 ________

30. Operating cost per loan made: line 25 from Monthly Financial Report divided by line 10 ________

31. Operating cost per Naira lent: line 25 from Monthly Financial Report divided by line 12 ________

32. Borrowers per credit officer: line 8 divided by line 9 ________

33. Amount lent per credit officer: line 12 divided by line 9 ________

34. Average size of loans disbursed this month: line 12 divided by line 10 ________

35. Operational self-sufficiency ratio [Note: Calculate at the end of March, June, September, and December for the previous 6-month period: From the Monthly Financial Reports: lines 3 divided by (lines 4 plus lines 6 plus lines 25)] ________

A Note on Terms/Definitions

1. "Number of clients" is defined as the number of both borrower/savers and savers. Individuals within groups should be counted, even when the loans are made to groups.

2. "Number of clients withdrawn" is defined as the number of clients who quit the program before their group receives a loan or after their individual or group loans were repaid or written off.

3. "Number of groups dissolved" is defined as the number of groups that quit the program before they received a loan or after their loans were repaid or written off.

4. "Number of loans disbursed" should include all loans to individuals within groups, even if the NGO's contract is with the group.

5. "Number of borrowers" should include all individuals within groups who have loans outstanding, even if the NGO's contract is with the group.

6. "Collection rate" is defined as the amount of principal paid during the month (inclulding late loans but excluding prepayments) divided by the amount of principal that was due in the month (including late loans).

7. "Loans written off" is defined as the amount declared nonrecoverable (usually, after more than 180 days in arrears) in the month.

Monthly Financial Report: Summary of All Operations

Preparer: ______________________________
NGO: ______________________________
Reporting Period (Month/Year): ______________________________

Financial Revenues

1. Interest/Fees/Dues Revenue from Borrowers ____________

2. Interest on Investments ____________

3. Total Financial Revenues (line 1 plus line 2) ____________

Financial Costs

7. Cost of funds ____________

5. Gross Financial Margin (line 3 minus line 4) ____________

6. Provision for loan loss ____________

7. Net Financial Margin (line 5 minus line 6) ____________

Operational Costs

8. Transport (to clients) ____________

9. Hotel Accommodation ____________

10. Entertainment ____________

11. Furniture, Fittings and Equipment ____________

12. Office Maintenance ____________

13. Staff Training ____________

14. Clients' Training ____________

15. Vehicle Maintenance ____________

16. Stationery ____________

17. Rents ____________

18. Salaries and Allowances ____________

19. Honoraria ____________

20. Publications/Printing ____________

21. Communication ____________
22. Bank Charges ____________

23. Depreciation ______________

24. Other Operational Costs ______________

25. Total Operational Costs (add lines 8 - 24) ______________

Other Operating Revenues

26. Other operating revenue (sale of forms, etc.) ______________

27. Net Operating Income/Loss (line 7 minus line 25 plus line 26) ______________

Other Revenues

28. Grants ______________

29. Other (describe) ______________

30. Total Other Revenues (line 28 plus line 29) ______________

Other Expenditures

31. Capital Purchases (list): ______________
____
______________ ______________

32. Other (describe): ______________ ______________

33. Total Other Expenditures (line 31 plus line 32) ______________

34. Net Income/Loss (line 27 plus line 30 minus line 33) ______________

Monthly Operations Account Summary

(Complete one report for each bank account and petty cash account used for operations)

Preparer: ______________________________
NGO: ______________________________
Bank account no: ______________________________
Reporting Period (Month/Year): ______________________________

I. Operations

1. Beginning cash balance (last month's ending cash balance) ____________

Financial Income

2. Interest from bank, other investments ____________

Financial Costs

3. Cost of capital – paid ____________

Operational Costs

4. Transport (to clients) ____________

5. Hotel Accommodation ____________

6. Entertainment ____________

7. Furniture, Fittings and Equipment ____________

8. Office Maintenance ____________

9. Staff Training ____________

10. Clients' Training ____________

11. Vehicle Maintenance ____________

12. Stationery ____________

13. Rents ____________

14. Salaries and Allowances ____________

15. Honoraria ____________

16. Publications/Printing ____________

17. Communication ____________
18. Bank Charges ____________

19. Other Operational Costs ____________

20. Total Operational Costs (add lines 4 - 19) ____________

Other Revenues

21. Grants __________

22. Other (list): ____________________

____

____________________ __________

23. Total Other Revenue (add lines 21 – 22) __________

24. Net Change in Cash (line 2 minus line 3 minus line 20 plus line 23) __________

II. Non-Operations

Transfers In

25. Transfers from (list all): ____________________

____

____________________ __________

Transfers Out

26. Transfers to (list all): ____________________

____

____________________ __________

Purchase of Capital Equipment

27. Purchase of new capital equipment (list all): ____________________

____

____________________ __________

28. Total Change in Account (line 24 plus line 25 minus line 26 minus line 27) __________

29. Ending Cash Balance (next month's beginning cash) (line 1 plus line 28) __________

Statement of Loan Fund Cash Position by Credit Bank Account
(Complete one statement for each credit bank account)

Preparer: ____________________________________
NGO: ____
Bank account no.: ______________________________
Reporting Period (Month/Year): ____________________

1. Beginning Cash Balance (last month's ending cash balance) ____________

Loan Activity

2. Amount of principal repaid ____________
3. Amount of interest and penalties paid ____________
4. Amount of fees and dues paid ____________
5. Amount of new loans made ____________
6. Interest from bank, other investments ____________
7. **Total Loan Activity** (line 2 plus lines 3 and 4 minus line 5 plus line 6) ____________

Transfers In

8. Transfers in (list all):
   8a. Savings deposits ____________
   8b. Grants ____________
   8c. From other account (indicate source): ________________ ____________
   8d. From other account (indicate source): ________________ ____________
9. **Total Transfers In** (lines 8a – 8d) ____________

Transfers Out

10. Transfers out (list all):
    10a. Savings withdrawals ____________
    10b. To other account (indicate account): ________________ ____________
    10c. To other account (indicate account): ________________ ____________
11. **Total Transfers Out** (lines 10a – 10c) ____________

Other Costs and Revenue

12. Cost of Capital – Paid (include interest paid on savings deposits) ____________
13. Bank Charges ____________
14. Other Costs (list): ______________________________ ____________
15. Other Revenue (list): ____________________________ ____________
16. Ending Cash Balance (next month's beginning balance) ____________
    (line 1 plus line 7 plus line 9 minus line 11 minus lines 12 – 14 plus line 15)

Monthly Bank Reconciliation Form

NGO: ______________________________

Bank: ______________________________

Month/Year: ______________________________

Name of Account: ______________________________

Account Number: ______________________________

Person Preparing Reconciliation: ____________________

Preparation Date: ______________________________

A.	Ending Balance per Bank Statement	________
B.	Add: Total Deposits in Transit (from schedule 1, below)	________
C.	Less: Total Checks Outstanding (from schedule 1, below)	________
D.	Ending Reconciled Balance (A plus B minus C = D)	________
E.	Ending Balance per Checkbook and Report	________
F.	Variance (should be zero) (D minus E = F)	________

Schedule 1

Deposits in Transit		**Checks Outstanding**	
Date/Number	Amount	Date/Number	Amount
Total		Total	

Loan Aging Report

NGO: ____________________

Product: ____________________

Reporting period (month/year): ____________________

Preparer: ____________________

No. Days Late	Balance of Loans in Arrears	Provision (%)	Provision for Loan Loss Reserve
1 – 30		10%	
31 – 60		50%	
61 – 90		75%	
91 – 120		85%	
121 – 180		100%	
Total			

Loan Loss Reserve at End of Prior Period: ____________________

Current Charge: ____________________

Monthly Loan/Savings Activity Summary

NGO: ______________________________

Loan Product: ______________________________

Preparer: ______________________________

Month/Year: ______________________________

Beginning Balances			Current Month Activity			End of Month Balances								
ID No.	Date of Disburse-ment	Principal Out-standing	Principal Repaid	Interest/ Penalties Paid	New Loans Dis-bursed	Principal Out-standing	Principal in Arrears	Principal at Risk	Interest Owed	Final Instal-ment Due Date	Total Savings	Length of Loan Term	No. of Clients: Total/ Women	No. of Bor-rowers: Total/ Women

Monthly Arrears Report

NGO: ______________________

Preparer: ______________________

Month/Year: ______________________

Borrower ID No.	Credit Officer Responsible	Loan Product	Principal in Arrears	Number of Days in Arrears	Principal at Risk	Date of Disbursement	Final Installment Due Date	Actions Taken

Monthly Disbursement Report

NGO: ______________________________

Preparer: ____________________________

Month/Year: __________________________

Borrower ID No.	Date of Disbursement	Amount of Loan Disbursed	Repayment Schedule (Amount Due By Month)			
			Month	Principal Due	Interest Due	Total Due

LOANS/SAVINGS LEDGER

Name of Group: ______________________________

ID No.: ______________________________

Number of Group Members: ______________________________

Number of Women Members: ______________________________

Number of Group Members with Loans: ______________________________

Loan Amount: ______________________________

Interest Due: ______________________________

Date of Disbursement: ______________________________

Loan Product/Loan Term: ______________________________

Installment Due Date (1)	Amount Due – This Installment (2)			Previous Amount in Arrears (3)			Total Amount Due (4)			Total Amount Paid (5)			Prepay-ments (6)			Total Paid to Date (7)			Amount in Arrears (8)			Amount Outstanding (9)			Dues Paid (10)	Savings (11)		
	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total	P	I	Total		Dep.	With.	Total

Notes:
Column 4 = column 2 plus column 3
Column 7 = column 4 minus column 5
Column 9 = Total principal and interest due minus total amounts from column 7
Column 5 (Total amount paid) includes amount in column 6 (Prepayments)