

## **Causes and Control of Loan Default/Delinquency in Microfinance Institutions in Ghana**

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### **Abstract**

*The study analysed the causes and control of loan delinquency/default in microfinance institutions in Ghana. Random sampling technique was used to select twenty-five microfinance institutions and two hundred and fifty clients for the study. Questionnaire and interview guide were used to collect data for the study. The study found the causes of loan default to include; high interest rate, inadequate loan sizes, poor appraisal, lack of monitoring, and improper client selection. Measures to control default were found to include training before and after disbursement, reasonable interest rate, monitoring of clients, and proper loan appraisal. It was recommended among others that MFIs should have clear and effective credit policies and procedures and must be regularly reviewed. It was concluded that the government and hence Bank of Ghana should regularly monitor and supervise the MFIs so as to ensure safety of clients' deposits and customers' confidence.*

**Keywords:** Microfinance Institutions, Loan Default, Loan Delinquency, Default rate, Micro, Small, and Medium Enterprises (MSMEs)

### **1.1 Introduction**

International organisations are coming to the realisation that Microfinance Institutions ( MFIs )are veritable and effective channels to ensure programme implementation effectiveness, particularly in poverty alleviation projects and firsthand knowledge of the needs and interest of the poor (Okumadewa, 1998). According to Chossudovsky (1998), the World Bank Sustainable Banking with the Poor project (SBP) in mid-1996 estimated that there were more than 1,000 microfinance institutions in over 100 countries, each having a minimum of 1,000 members and with 3 years of experience.

Microfinance Institution may be defined as any financial institution which offers not only small loans to microenterprises, SMEs, groups and individuals but also provides other financial services like savings, insurance, and investment advice including even training programmes to its clients.

The issue of loan delinquency/default among banks and Microfinance Institutions has been discussed in many public lectures and fora as one of the reasons why commercial banks have not shown much interest in financing Micro, Small and Medium Enterprises (MSMEs). According to Balogun and Alimi (1990), loan default can be defined as the inability of a borrower to fulfil his or her loan obligation when due. High default rates in MSMEs lending should be of major concern to policy makers in developing countries, because of its unintended negative impacts on MSMEs financing. Microfinance institutions all over the world including Ghana are faced with the challenge of loan default/delinquency.

The chance that a microfinance institution (MFI) may not receive its money back from borrowers (plus interest) is the most common and often the most serious vulnerability in a microfinance institution (Warue, 2012). According to her since most microloans are unsecured, delinquency/default can quickly spread from a handful of loans to a significant portion of the portfolio. This contagious effect is worsened by the fact that microfinance portfolios often have a high concentration in certain business sectors. Consequently, many clients may be exposed to the same external threats such as lack of demand for clients products, livestock disease outbreak, bad weather and many others. These factors create volatility in microloan portfolio quality, heightening importance of controlling credit risk. In this regard, MFIs need a monitoring system that highlights repayment problems clearly and quickly, so that loan officers and their supervisors can focus on delinquency (repayment rate) before it gets out of hand. In lending services, a default is the failure to pay back a loan.

The Microfinance Institutions in Ghana including the private microfinance institutions, rural and community banks, and some Commercial banks are faced with loan delinquency/default, which may have long-term consequences if not addressed.

### **1.1.1 Statement of the Problem**

The sustainability of microfinance institutions depends largely on their ability to collect their loans as efficiently and effectively as possible. In other words to be financially viable or sustainable, microfinance institutions must ensure high portfolio quality based on 100% repayment ,or at worst low delinquency/default, cost recovery and efficient lending.

However of late, there have been complains by the microfinance institutions regarding high rate of default/delinquency by their clients; which presupposes that most microfinance institutions are not achieving the internationally accepted standard portfolio at risk of 3%, which is a cause for concern because of its consequences on businesses, individuals, and the economy of Ghana at large. Delinquency and hence default have started creeping deeply into the operations of microfinance institutions in Ghana hence the study into the causes and control of loan delinquency/default in microfinance institutions in Ghana.

### **1.1.2 Objectives of the Study**

The study generally investigated the causes and control of loan default in microfinance institutions in Ghana.

Specifically, the objectives of the study included the following;

- To examine the causes of loan default/delinquency in microfinance institutions in Ghana.
- To recommend measures to control the default/delinquency in Ghana.

### **1.1.3 Research Questions**

The study attempted to address the following questions:

- What are the causes of loan delinquency/default in microfinance institutions in Ghana?
- What measures can be employed to control loan delinquency/default?

## **2.1 Literature Review**

### **2.1.1 The Concepts of Loan Delinquency and Loan Default**

A loan is delinquent when a payment is late (CGAP, 1999). A delinquent loan becomes a defaulted loan when the chance of recovery becomes minimal. Delinquency is measured because it indicates an increased risk of loss, warnings of operational problems, and may help to predict how much of the portfolio will eventually be lost because it never gets repaid.

There are three broad types of delinquency indicators: collection rates which measures amounts actually paid against amounts that have fallen due; arrears rates measures overdue amounts against total loan amounts; and portfolio at risk rates which measures the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans (CGAP, 1999).

Default occurs when a debtor has not met his or her legal obligations according to the debt contract. For example a debtor has not made a scheduled payment, or has violated a loan covenant (condition) of the debt contract (Ameyaw-Amankwah, 2011). A default is the failure to pay back a loan. Default may occur if the debtor is either unwilling or unable to pay their debt. A loan default occurs when the borrower does not make required payments or in some other way does not comply with the terms of a loan. (Murray, 2011).

Moreover, Pearson and Greeff (2006) defined default as a risk threshold that describes the point in the borrower's repayment history where he or she missed at least three instalments within a 24 month period. This represents a point in time and indicator of behaviour, wherein there is a demonstrable increase in the risk that the borrower eventually will truly default, by ceasing all repayments. The definition is consistent with international standards, and was necessary because consistent analysis required a common definition. This definition does not mean that the borrower had entirely stopped paying the loan and therefore been referred to collection or legal processes; or from an accounting perspective that the loan had been classified as bad or doubtful, or actually written-off. Loan default can be defined as the inability of a borrower to fulfil his or her loan obligation as at when due (Balogun and Alimi, 1990).

### **2.1.2 Causes of Loan Delinquency/Default**

According to Ahmad, (1997), causes of loan default include; lack of willingness to pay loans coupled with diversion of funds by borrowers, wilful negligence and improper appraisal by credit officers. In addition, Hurt and Fesolvalyi (1998), cited by Kwakwa, (2009) found that, corporate loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers. Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small farm size, high interest rate, age of farmers, poor supervision, non profitability of farm enterprises and undue government intervention with the operations of government sponsored credit programmes. Moreover, Akinwumi and Ajayi (1990) found out that farm size, family size, scale of operation, family living expenses and exposure to sound management techniques were some of the factors that can influence the repayment capacity of farmers. According to Olomola (1999), loan disbursement lag and high interest rate can significantly increase borrowing transaction cost and can also adversely affect repayment performance. After surveying different banks in India, Berger and De Young(1995) identified the main causes of default of loans from industrial sector as improper selection of an entrepreneur, deficient analysis of project viability, inadequacy of collateral security/equitable mortgage against loans, unrealistic terms and schedule of repayment, lack of follow up measures and default due to natural calamities. The study conducted by Okorie (1986) in Ondo state in Nigeria revealed that the nature, time of disbursement, supervision and profitability of enterprises, contributed to the repayment ability and consequently high default rates. Other critical factors associated with loan delinquencies are: type of the loan; term of the loan; interest rate on the loan; poor credit history; borrowers' income and transaction cost of the loans. Okpugie (2009) also indicated that, high interest charged by the microfinance banks has been discovered to be the reason behind the alarming default. This was also confirmed by Vandell (1993), who also found that high interest rates charged by banks tend to facilitate default by borrowers. According to Gorter and Bloem (2002) non-performing loans are mainly caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (bad weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. The problem of non-performing loans is widespread. Nishimura, Kazuhito, and Yukiko, (2001) state that one of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem. They explained that some of the loans made to companies and industries by financial institutions during the bubble era became non-performing when the bubble burst. This delayed structural reforms and prevented the financial intermediary system from functioning properly. Most of the defaults arose from poor management procedures, loan diversion and unwillingness to repay loans, Kohansal and Mansoori (2009). According to them a number of factors can cause loan defaults some of which are: Interest rate ceilings usually imposed by the government, monopoly power in credit markets often exercised by informal lenders, large transaction costs incurred by borrowers in applying for loans, moral hazard problems and many more.

From the findings of the study conducted by Warue(2012) in Kenya, most cases of loan delinquency are caused by microfinance institutions and self help groups' management failure to efficiently manage specific factors which are considered to be within the direct control of the MFIs' and Self Help Groups' (SHGs') management. The external factors outside the direct control of the MFIs' and SHGs' management seem to contribute little to the levels of delinquent loans. Therefore, for effective management of delinquency, it is critical for MFIs to understand and focus more on the internal causes of delinquency which they have more control over and seek practical and achievable solutions to redress these problems.

The upheaval that hit mainstream financial markets and the effects that continue to be felt across the globe from the resulting economic crisis impacted MFIs and their clients. The early stages of the downturn saw MFIs experience significant liquidity shortages, but as the capital markets recovered, concerns turned from funding to asset quality (CGAP, 1999). This scenario points to links between external factors and loan delinquency. The relationship between the macroeconomic environment and loan quality has been investigated in the literature linking the phase of the business cycle with lending institutions stability. For instance Fofack (2005) studied causal analyses and macroeconomic implication on loan default in Sub-Saharan countries. Fofack showed that, macroeconomic stability and economic growth are associated with a declining level of default; whereas adverse macroeconomic shocks coupled with higher cost of capital and lower interest margins are associated with a rising scope of nonperforming loans.

The findings of Waweru & Kalani (2009) indicated that some of the causes of non-performing loans in Kenyan banks were national economic downturn, reduced consumer buying ability and legal issues. The study appreciates that the nonperforming loan and loan delinquency concepts are similar.

Inadequate financial analysis according to Sheila (2011) is another cause of loan default. This is when in the loans department the officers do not take a careful study of the applicants to ensure that he/she has a sound financial base such that the risk of loss is mitigated in case of default. Sheila (2011) also points out that in Uganda; the issue of inadequate loan support is another cause of loan default. He says that it is very important that the loan personnel collectively ascertain the position in which the loanee finds himself/herself so that in case he needs support, it's availed to him or her. Unfortunately that is not the case even when the support is given it is not adequate which leaves the business crumbling and hence leading to default. The research also pointed out that illiteracy and inadequate skills was another cause of default. Majority of the clients are engaged in traditional, low paying businesses and rarely diversify their businesses and skills. This implies that they do not have enough knowledge about alternative marketable skills that can benefit them when their businesses do not function properly. Secondly, most of them do not know how to read, write and make simple calculations. As a result, they do not know how to account for their businesses even when the lender makes an error, the borrowers are held liable to the loan. Again disappearance of loan clients was seen as another cause.

Poor business practice is yet another cause. Kasozi (1998) was of the view that, there are weaknesses of the borrower over which the lender has little control. Management of the business is also an essential part that needs to be emphasised. You find that many borrowers lack the technical skills like keeping records and checking on the business performance until the time of paying back the loan. This is usually hard because they never plough back the profits leading to loan default in the long run.

Competitive factors cause loan losses and default according to the study. This occurs when as a result of existence of many banks/MFIs being involved in the business of lending, it becomes difficult to attract customers so the MFIs even go to the extent of not asking for adequate collateral just have borrowers. And this has led to many of the people's property being confiscated.

Some of the factors that lead to loan default include; inadequate or non-monitoring of micro and small enterprises by banks, delays by banks in processing and disbursement of loans, diversion of funds, over-concentration of decision making, where all loans are required by some banks to be sanctioned by Area/Head Offices (Bichanger and Aseya, 2013).

The study conducted by Nguta, and Guya (2013) in Kenya showed that one of the causes of loan default is the characteristic of the business. It was revealed that high cases of default of loan repayment were common (67.9%) in the manufacturing sector. This was followed by the service industry (64.0%) then by the agriculture (58.3%). The trade sector recorded the least (34.9%) cases of loan repayment defaults. This could be attributed to the observation that trade industry deals in fast moving products on high demand which could translate into good business performance and increased revenue that accounts for low default cases. Among businesses that had been in operation for less than two years, 52.4% had defaulted in loan repayment, 44.2% of those that had been in operation for a period of between two and five years had defaulted. It was noted that the highest (78.6%) default cases were regular in businesses that had been in operation for a period of between five and ten years. Loan repayment defaults were rare (0.0%) in business that had survived for more than 10 years. In addition, the businesses located within the municipality had high loan repayment default rates (55.7%) as compared to business outside municipality. Businesses making monthly profits of below Kshs. 10,000 had the highest cases (62.8%) of loan repayment default followed by those that made profits of between Kshs. 11,000 and Kshs. 50, 000 (42.5%). There were 22.7% cases of loan repayment default among businesses that made profits of between Kshs. 51,000 and Kshs. 100,000. Loan repayment default among businesses that made profits of over 100,000 was minimal.

### **2.1.3 Measures to Control Loan Delinquency/Default**

Kohansal and Mansoori (2009) were of the view that, lenders devise various institutional mechanisms aimed at reducing the risk of loan default. These include pledging of collateral, third-party credit guarantee, use of credit rating and collection agencies, etc.).

Kay Associates Limited (2005) cited by Aballey (2009) states that bad loans can be restricted by ensuring that loans are made to only borrowers who are likely to be able to repay, and who are unlikely to become insolvent.

Credit analysis of potential borrowers should be carried out in order to judge the credit risk with the borrower and to reach a lending decision.

Loan repayments should be monitored and whenever a customer defaults action should be taken. Thus banks should avoid loans to risky customers, monitor loan repayments and renegotiate loans when customers get into difficulties (Ameyaw-Amankwah, 2011). MFIs need a monitoring system that highlights repayment problems clearly and quickly, so that loan officers and their supervisors can focus on delinquency before it gets out of hand (Warue, 2012).

Sheila, (2011) is of the view that proper and adequate appraisal is key to controlling or minimising default. This is the basic stage in the lending process. According to Anjichi (1994), the appraisal stage is the heart of a high quality portfolio. This includes diagnosing of the business as well as the borrower. Before beginning the process of collecting information on the client for the purpose of determining credit limits, the loan officer should have specific information available which will guarantee that the data and figures provided by the client will have a pro-margin error (Sheila, 2011).

The majority of the information is obtained by the loan officer through direct interaction with the client in such a way that each loan analysis provides valuable insights for evaluating the application for the future client. However, most clients withhold a great deal of information making the evaluation a difficult and unreliable exercise. Furthermore, the loan officer should visit the home or the work place of the client with the main objective of determining whether the client needs the loan programmes or not. This information will help the loan officer to assess the ability to effectively utilise the loan. Hunte (1996), observed that the time to assess the applicant's credit worthiness also matters. He argues that the longer it takes to assess the applicant, the better. This is because he believes that a shorter time is not enough to fully assess the applicant. This is in agreement with Bigambah (1997) who contends that it is necessary to analyse the client before a loan is issued; the applicant has to be screened to assess his or her credit worthiness. That is the ability to repay the loan, the business and the guarantee to secure the repayment of the loan. Bigambah (1997) observed that the loan default in Uganda has identified loan appraisal as the key factor. In a number of cases, the information received is not verified, in some cases the information received is doctored or falsified. It must therefore be emphasised that credit risk analysis is another important element in loan appraisal. When lending out money, the lender should consider the borrowing proposition and subsequent repayment in isolation from security. It should be noted that, the borrower should be screened basing on the future and the past. Lending should be based on capital, character, capability, purpose, amount, repayment, term and security. Basing on the knowledge above, the lender should investigate on the customer's record, ability and experience. Security tends to come towards the end and is considered only after the borrowing proposition has met the criteria. This process of appraising the client will help the officer to assess the ability of the borrower to utilize the loan effectively. Furthermore; the loan officer will be able to predict the likely changes or effect on the business for which the money is being lent out. Another stage in the lending process which is critical to minimising default is the disbursement stage according to Sheila(2011). This stage is regarded as the most demanding to borrowers which often times leads to failure to meet their loan obligations. This is because most of the financial institutions take long to disburse funds to successful applicants. This affects the borrowers in that they take long to buy inputs needed to carry out their activities hence end up spending it unnecessarily. The most affected are those involved in the agricultural sector because their activities are usually in line with the prevailing weather conditions. If the people involved in the agricultural sector receive the loan late, this will delay the planting season hence they end up not making any profit in time or may yield less as a result they are not able to pay their loans in time.

To control default MFIs should also carefully examine the monitoring and control stage in the lending process (Sheila, 2011). Anjichi (1994) lamented that, many of the agonies and frustrations of slow and distressed credits can be avoided by good loan supervision which helps in keeping a good loan good. This is done by visiting the borrowers' premises to investigate the general state of affairs, checking on the state of borrowers' morale and physical stock of finished goods. The general business policy and advice are considered. If the MFI is sensitive to business development, it can revise its own credit policies and loan procedures as well as advising its customers. It can also monitor the disbursed loans by the use of loan tracking sheets, checking the amount deposited and the remaining balance of the borrowers. He further says that early recognition of the loan default is crucial, and therefore tries to give guidelines on managing loan losses.

These guidelines include immediate recognition of non-performing loans, re-appraising the borrowers' financial positions in respect to the market share and extending of payment period where necessary.

Saywer (1998) noted that it is essential for the lender to take an active interest in the borrower and monitor his continuing ability to repay the debt. On monitoring, the lender should focus on the actual sales per month and compare with the monthly budget and reasons for any variance. This regular touch with the borrower will enable the lender to receive early warning of any problem. Bigambah (1997) observed that the frequent visits help to ensure that the client is maintaining the business and intend to repay the loan. The frequent visits allow the loan officer to understand the clients business and appropriateness of the loan term (amounts, frequency of repayments and repayment period) otherwise, the chances of loan default to occur are high. Mugisha (1995) asserts that non performing loans in Uganda are usually as a result of weak banking systems. He says that lending institutions in Uganda lack enough skilled loan personnel which become hard to make a follow up of the loan applicants hence they end up defaulting.

According to Warue (2012) Microfinance institutions regulators, credit referencing bureau and MFIs policy makers have to be wary about increasing loan delinquency in the industry and put in place appropriate management strategies to mitigate portfolio at risks. In addition MFIs management should regularly review credit risk techniques used and expand loan monitoring framework among Self Help Group (SHGs) for effective credit portfolio assessment. Further SHGs management should strengthen group solidarity to facilitate prompt loan repayment by the group members.

In the view of Saloner (2007), group lending will also minimize loan default. Many microfinance institutions borrow in groups and choose to lend to groups of borrowers rather than on an individual basis. As opposed to ROSCAs, the microfinance institutions provide the loans so that the borrowers are not limited to the money that they themselves can contribute. The general organisation of group lending consists of a group of borrowers who work together, support, and mentor one another to maximise the impact that the loan can have on each individual. Additionally, in many group lending situations, the members of the group are responsible for selecting new members and for the timely repayment by other members, known as joint liability. As a result, group lending tends to lead to superior performance by the borrowers in operating their businesses and better rates of loan repayment.

Several studies have been performed on the group lending aspect of microfinance, and most research shows it to be an effective method. Woolcock (2001) builds on the theory that group lending leads to improved performance by the borrowers. He explains that in addition to the support and guidance from the group, there is also a strong incentive for each individual to operate effectively due to one's personal reputation within the group. Furthermore, since groups generally are formed of members from the same village or community, repaying loans on time and in full affects a borrowers standing within the community at large, not limited to the lending group. However, while this social effect can produce positive outcomes for the microfinance institutions, some researchers believe that it can lead to an unhealthy social environment. Islam (1995) examines the effect of lending groups from the perspective of the microfinance institutions. His study finds that group lending provides a strong system of peer monitoring, which in turn provides the institutions with the ability to be more flexible with their finances, either charging lower rates than other lenders or charging the same rate and receiving higher rates of repayment with lower risks. Although most of the research on joint lending finds positive effects, an empirical study of microfinance institutions and borrowers in Thailand concluded that, contrary to conventional understanding, joint lending does not have a significant effect, either positive or negative, on the repayment of loans (Kaboski and Townsend 2005).

The general consensus in the literature on group lending and group liability is that group lending benefits both the borrowers and the institutions. The borrowers receive the additional support and assistance from a group of individuals dealing with the same types of issues. Furthermore, the institutions are able to lower costs by relying on the lending groups to provide these services that otherwise would be required from the institution itself. Group lending also works to move institutions into a more client-led realm, which has proven to be more effective in creating sustainable development programmes.

### **3.1 Methodology**

The study used survey design involving both quantitative and qualitative approaches. The population for the study was all microfinance institutions and their clients in the city of Accra, the capital of Ghana. Random sampling was used to select twenty-five(25) Microfinance Institutions(MFIs) from Accra. In each of the MFIs, two (2) employees including the CEO/MD and the head of credit department was purposively chosen for the study; so in all fifty (50) employees from the microfinance institutions were chosen for the study. In addition to the employees, ten (10) clients from each microfinance institutions (MFIs) were also randomly selected, implying that two hundred and fifty (250) clients in all were used in the study. The research instruments used for the study were questionnaire and interview guide.

### **4.1 Results and Discussion**

#### **4.1.1 Causes of default/delinquency in MFIs in Ghana**

The following were the causes of loan default enumerated by the clients: Late disbursement of the loan, business failure, unfavourable payment terms, high interest rate, inadequate loan sizes, unforeseen contingencies, for instance illness and death of a family member, lack of training for the clients before and after disbursement. These confirm the findings of the study by a number of researchers. For instance Okorie(1986) found that time of disbursement is a major cause of loan default among microfinance clients. Secondly Vandell (1993) and Okpugie (2006) in separate studies found that high interest rate charged by microfinance institutions is a major cause of default among the microfinance clients.

Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small farm size, high interest rate, age of farmers, poor supervision, non profitability of farm enterprises and undue government intervention with the operations of government sponsored credit programmes.

The MFIs also identified some of the major factors of default/delinquency in MFIs in Ghana to include poor appraisal, lack of monitoring or improper monitoring, improper client selection, diversion of funds on the part of clients, unwillingness of clients to pay, lack of training for the clients, illiteracy and inadequate skills of clients, poor business practices, and macroeconomic factors, poor management styles among others. These factors or causes confirm the findings of the study conducted by Ahmad, (1997), who found that lack of willingness to pay loans coupled with diversion of funds by borrowers, wilful negligence and improper appraisal by credit officers are some of the causes of loan default.

#### **4.1.2 Measures to Minimise/Control Default/Delinquency in MFIs in Ghana**

Among the measures mentioned by the clients were timely disbursement of loan, adequate loan sizes, training before and after disbursement, flexible payment terms, reasonable interest rate, and monitoring of clients among others. These measures confirm the findings of the studies conducted by Bigambah (1997) who observed that frequent visits/monitoring help to ensure that clients maintain the business and intend to repay the loan. The frequent visits allow the loan officer to understand the clients business and appropriateness of the loan term (amounts, frequency of repayments and repayment period).

From the MFIs point of view quick follow-up after a missed payment, regular visits to homes and businesses of clients, adequate and proper appraisal, proper client selection, group lending, use of third party guarantee among others are the major measures to control or minimise default/delinquency. These are consistent with the findings of the studies conducted by Anjichi (1994) who lamented that, many of the agonies and frustrations of slow and distressed credits can be avoided by good loan supervision which helps in keeping a good loan good. This is done by visiting the borrowers' premises to investigate the general state of affairs, checking on the state of borrowers' morale and physical stock of finished goods.

#### **Rate of Default**

Out of the 25 MFIs, 10 representing 40% are experiencing a default rate of <1-3% which is consistent with internationally accepted rate of default. Eight(8) representing 32% have default rate of > 3-6%, 4(16%), experience default rate of >6-10%, and 3 representing 12% have a default rate of more than 10%. The implication is that 60% of the MFIs have their default rates more than the internationally acceptable rate of 3%. This must be seriously checked else can lead to the collapse of the MFIs. Table 1 demonstrates the rates of default.

**Table 1: Rate of Loan Default**

<b>Rate of default</b>	<b>Frequency</b>	<b>Percentage (%)</b>
<1-3%	10	40%
>3- 6%	8	32
>6-10%	4	16
>10%	3	12
<b>Total</b>	<b>25</b>	<b>100.0</b>

Source: Field data, 2014

#### **4.1 Conclusion and Recommendations**

The causes of loan default by clients of MFIs differ; clients assign different factors, while loan officers who are on the field also assign different factors. It is found that factors assigned by clients as reasons for default of payment are not explicitly the main reasons thereby much consideration should be given to that of loan officers in order to reduce loan default.

□□It must be noted that the MFIs have the potential for helping create wealth and hence reduce poverty, so government and for that matter bank of Ghana should ensure their success, so that they do not collapse.

The following are recommended to control or minimise default.

The formation of strong solidarity groups is key to preventing high arrears. The training and formation stage often covers several sessions. Group members must clearly understand their roles and responsibilities and fully understand that they are individually signing for the loans of each group member.

MFIs should have clear and effective credit or lending policies and procedures and must be regularly reviewed. The credit supervisor should check with credit officers daily to ensure that policies are followed and the supervisor must respond quickly to solve credit officers' problems. It makes no sense to have strong policies on paper that are not followed in the field. Next, if credit officers have a specific geographic region, they can visit clients more often; limiting geographic scope, reduces time and money wasted traveling from the office to clients' businesses. More visits enable credit officers to develop relationships in their neighbourhoods. Management and credit officers need to pay attention to details. The average arrears rate of each credit officer's portfolio should be tracked weekly or bi-weekly. Credit officers must respond quickly to problem clients in their portfolios.

Another strategy for reducing arrears is to loan only to micro entrepreneurs who have been in business for at least twelve months. Businesses are most likely to fail within the first year of operation so if they have existed for at least twelve months on the owner's money, the infusion of money from the MFI should be at a lower risk than if the business is a start-up.

Yet another way to reduce arrears/default is for MFIs to require the credit officer to visit the client and the client to receive training prior to the disbursement of each loan. It is easy for MFIs to assume that a client or group should get larger loans after each loan cycle, assuming that clients will repay new loans on time if they have repaid past loans on time. However, it is often on the second and third loans that clients fall behind, perhaps because the loan size has grown too big or because the client has begun to take the MFI for granted. The MFI should apply the same rigorous financial and character tests to both new and repeat loans.

Financial incentives can be used to lower the arrears/default rates for individual credit officers. According to Stearns (1997) another strategy that has proven quite effective in finding solutions to default is to design an incentive system for the loan officers that include on-time payments as an important variable. If well designed, the system can motivate credit officers to look for and eliminate the causes of arrears, as well as to meet other programme objectives.

If the arrears/default rate rises to such an extent that it threatens the life of the MFI, management must suspend lending to new clients until the Portfolio at Risk (over one day) ratio falls an acceptable level. Credit officers should be more careful with client selection.

In the area of recruitment, the MFIs should recruit skilled personnels especially credit officers and they should be regularly trained.



Another strategy is for the credit officer to classify the client into one of the following four categories:

(1) willing and able to repay, (2) willing but unable to repay, (3) unwilling but able to repay, and (4) unwilling and unable to repay.

The management of the MFI could consider the following courses of action.

**Willing and Able to Repay.** Management could allow credit officers to receive payment, even partial payment, at the client's business or home.

**Willing but Unable to Repay.** Rescheduling should be considered for clients with a very good excuse. This means that the principal, interest due, and penalty due are added up as the starting balance on a new loan, for which the client signs a new loan contract. Rescheduling can, however, hide a problem that can resurface in a worse condition, even encouraging delinquency.

The day of reckoning comes when repayments start again. The MFI does not have any guarantee that late payments will not occur again.

**Unwilling but Able to Repay.** The institution can pursue legal action or inform the community and influential persons of clients' unwillingness to repay. Their names can be publicly posted. Religious and community leaders can push them to pay. Community leaders can be informed that the MFI will stop lending in the neighbourhood if arrears are too high. The entire neighbourhood could lose because of several persons' unwillingness to honour their legal obligations. Handing clients over to debt collectors should be considered, but the institution then loses most of its leverage. Another option is to train staff in debt collection; perhaps an attorney could help the MFI develop this capacity.

**Unwilling and Unable to Repay.** Following up on such groups is a poor use of staff time. They are best referred to debt collectors or written off.

Finally the government and hence bank of Ghana should also regularly monitor and supervise the MFIs so as to ensure safety of clients' deposits and customers' confidence.

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