



Micro Loans and Micro Savings: Key Success Factors

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Introduction

Micro Loans and Micro Savings: Basic Financial Services for the Mass Market and Economically Poor

WORKSHOP OBJECTIVES

By the end of the workshop the participants will:

- Have a better understanding of the Basic Principles and Best Practices in promoting micro loans and micro savings
- Appreciate the best practices in preventing and managing risks in micro loans and micro savings
- Know the experiences of other banks and microfinance institutions around the world.

AGENDA

- A look at microfinance in Nigeria
- Micro Loans
- Micro Savings
- Management of problem loans

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INTRODUCTION

MICROFINANCE IN NIGERIA

- The Federal Government has created an enabling environment .
- CBN has also adopted a proactive approach towards the development of the industry
- The year 2007 evidenced the compulsory conversion of community banks to microfinance banks. However most MFB's created lack the technical and financial capacity to maximize available opportunities
- Broad based microfinance policy has been introduced .
- Vision is of a vibrant micro-finance sub-sector ,adequately integrated into the mainstream of the national financial system and able to provide the s

KEY DEMOGRAPHICS

- 958 MFB's as at Dec 2015
- Total adult population of 93.5m
- Large rural population of 63.9%
- 60.5% are financially served
- 39.5% are excluded
- 55.9% of adult males unbanked- 24.3m
- 70.6% of adult females unbanked
- 75% of rural population unbanked

TARGET MARKET

- Primary target is the large number of Nigerians outside the formal banking network.
- Microfinance takes banking to the grassroots.
- The formal financial system provides services for less than 50% of the economically active population i.e. 50% are excluded from available financial services and are largely served by the informal sectors.
- The target market has broadened from micro enterprises to include low income households encompassing both business and family needs

MOTIVATION FOR INVOLVEMENT

- Vast potential market for retail financial services
- Sustainable profit and growth opportunities identified.
- Increasing competition in traditional Retail Markets.
- Explore new markets likely to generate growth in client numbers at acceptable profit margin.
- Economic and social development (CSR)

OBJECTIVES

- Effectively access new markets
- Mobilize savings at the grass roots
- Increase productivity and employment for the poor, and in general terms integrate the poor into the socioeconomic development process.
- Administer and channel government micro credit programs

PERFORMANCE THUS FAR'

- Encouraging public interest and response
- Poor understanding of the microfinance concept and methodology
- Large percentage of Target market still excluded
- In June 2010 an evaluation of MFB's by the CBN found 224(27%) to be terminally distressed and technically insolvent, resulting in the revocation of their operating licenses

Factors contributing to unsoundness included-

- High NPL levels
- Poor corporate governance
- High operating costs
- Heavy investment in fixed assets
- Failure to meet obligations to customers

Micro Loans and Micro Savings: Best Practices

- Set Clear Strategic Direction
- Create Supportive Structure
- Adopt Market-driven Product Development Approach



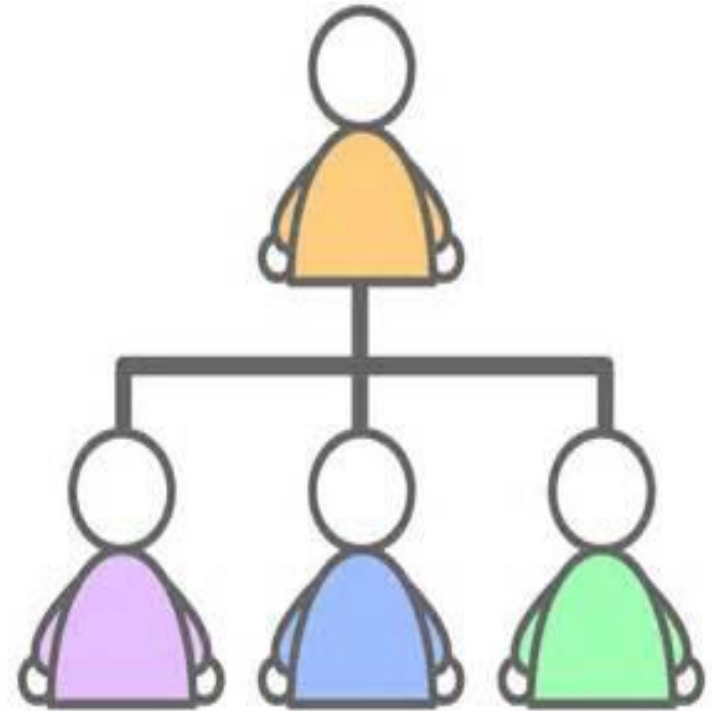
Micro Loans and Micro Savings: Best Practices

- Establish Clear Policies and Processes
- Put in Place Good MIS
- Adopt Strong HR Management System
- Sound Risk Management



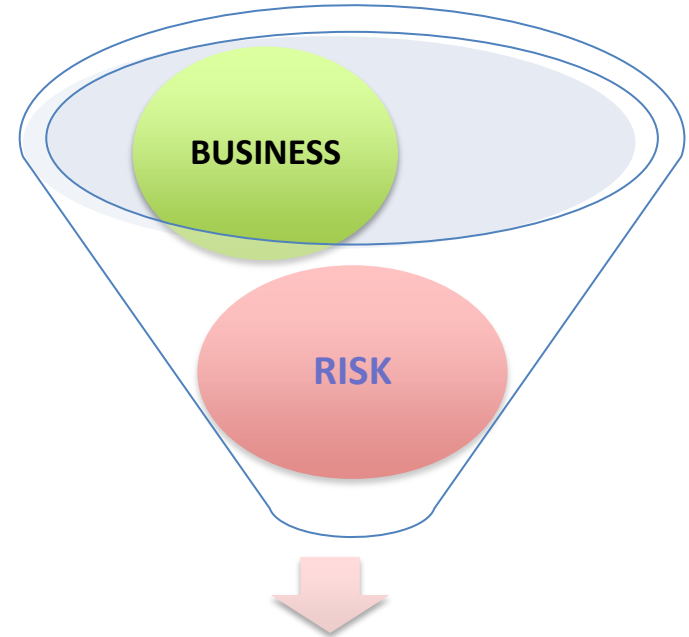
Best Practices: Supportive Structure

- Treat micro loans and micro savings as independent business lines.
- Micro loans should be handled by a separate team.
 - Have a product champion, micro loan officers



Best Practices: Supportive Structure

- Separate business and credit risk management functions.
- Establish clear reporting lines.



Best Practices: Market-driven Product Development Approach

- Segment the Market and identify your target group
- Know what they need (survey, FGDs)
- Understand what you can offer



Best Practices: Market-driven Product Development Approach

- Define features and delivery mechanism of the product you want to offer
- Document policies and procedures



Best Practices

- Train staff
- Pilot test new product
- Evaluate pilot result
- Make adjustments, when necessary
- Rollout (by phases)
- Evaluate result periodically

Best Practices: Well-defined and Efficient Processes

- Establish process flows
- Evaluate turnaround time
- Evaluate error rate
- Automate processes, if applicable



Best Practices: Good MIS

- User-friendly system
- Simple, accurate and timely reports
- Good internal control mechanism



Best Practices: Strong HR Management System

- Clear, relevant HR strategy
- Updated job grades and salary scale
- Well planned human resource development program
- Effective performance management system
- Performance-based incentive scheme
- Well defined career paths

Best Practices: Sound Risk Management System

- Built-in measures to:
 - Prevent, mitigate, measure, report risk events
- Periodic risk assessment mechanism
- Independent, random validation mechanism
- Well defined processes in:
 - Customer intake
 - Underwriting
 - Approval
 - Monitoring

Micro Loans and Micro Savings: Basic Characteristics

Micro Loans

- For business purpose
- Payable in frequent, small installments
- Reasonable, easy to comply document requirements
- Match the loan structure with the purpose
- Match repayment schedule with cash flows

Micro Loans and Micro Savings: Basic Characteristics

Micro Savings

- Easily accessible
- Low maintaining balance
- Low transaction fees
- Not too many restrictions
- Assurance of safety

Micro Loans: Approaches

- Individual lending
- Clustered lending
- Value Chain Approach
- Tripartite Lending Scheme

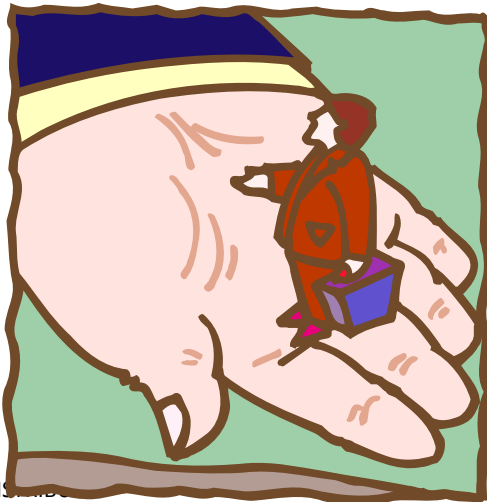
Micro Loans : Greatest Challenges

- Controlling risk
- Lack of credit bureau
- Inefficient collateral registry offices
- Collection, collection, collection

Best Shield....



- Savings
- Insurance



De-Risking Micro Loans



Credit risk is the potential that a bank borrower will fail to meet its obligations in accordance with agreed terms.

Market risk is the risk of losses in on- and off-balance-sheet positions arising from movements in market prices.

Operational risk is the potential loss resulting from inadequate or failed internal processes or systems, errors, or external events.

Foreign exchange

Interest rate

Equity

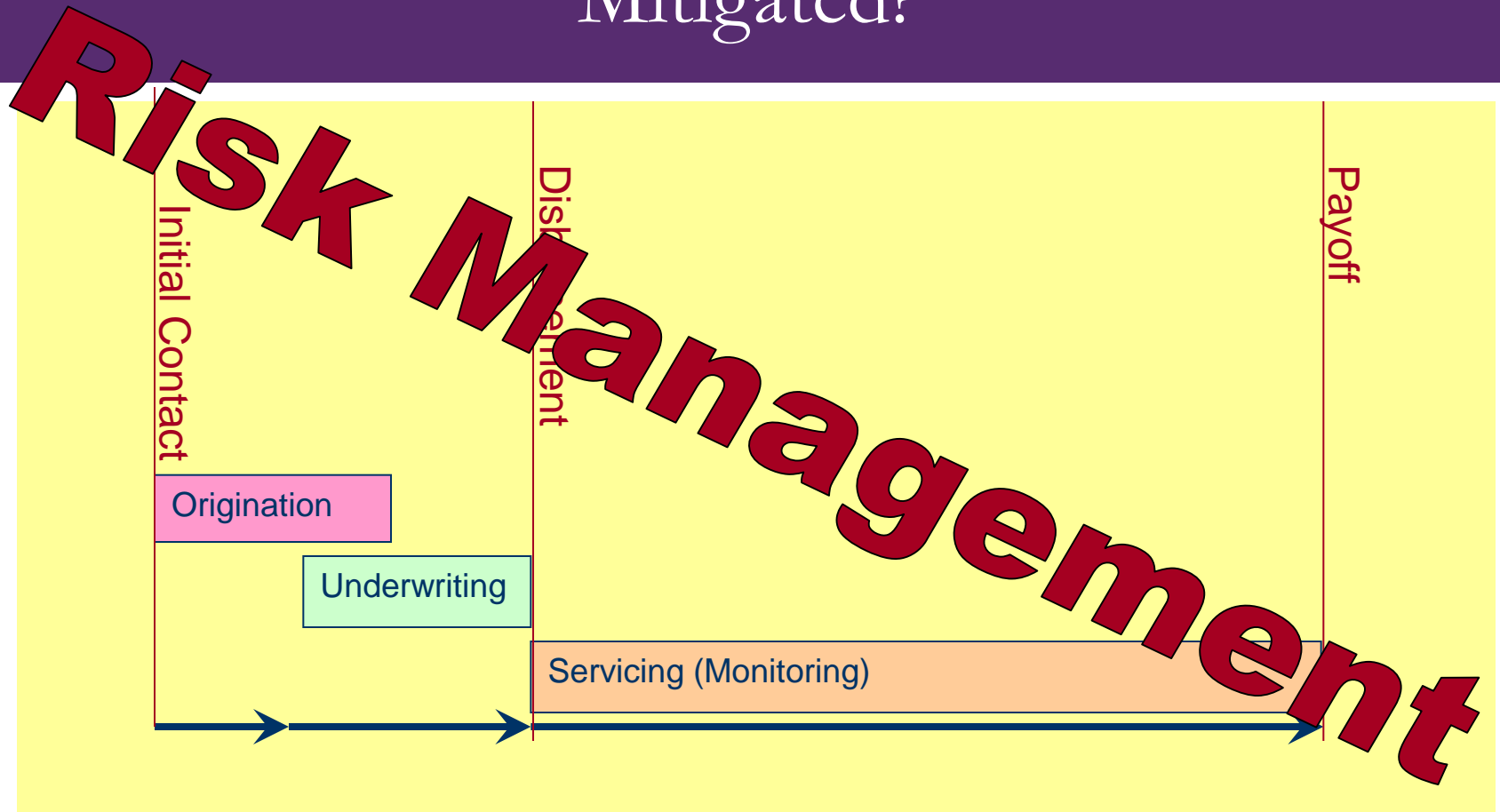
Commodity



Which of these risks poses the greatest long term threat to a financial institution?

CREDIT RISK!!!

At What Stage In Lending Should Risk Be Mitigated?



It's a continuum: a series of coherent processes that cannot be separated from each other

De-Risking Micro Loans: Key Strategies

- Prevention – Pre-disbursement phase
- Account management
- Remedial Management – Delinquent Loans

De-Risking Micro Loans: Prevention

Pre-disbursement

- Good client selection
- Conscientious loan appraisal
- Independent approval system
- Controlled loan disbursement system

Post-disbursement

- Effective monitoring system
- Random field validation
- Zero tolerance to loan delinquency
- Efficient PDO management

Knowing the Risk Drivers:

Loan Origination

- Loose vetting of applicants
- Un-detected health problems of clients
- Oversight in assessing location
 - Prone to fire, flooding, theft

Underwriting

- Incomplete and/or Un-validated information and documentation
- Lack of knowledge of the business dynamics
- **Short cuts in appraisal and approval**

Knowing the Risk Drivers:

Disbursement

- Incomplete or errors in documentation
- Un-authorized disbursement
- Non-fulfillment of loan conditions

Knowing the Risk Drivers:

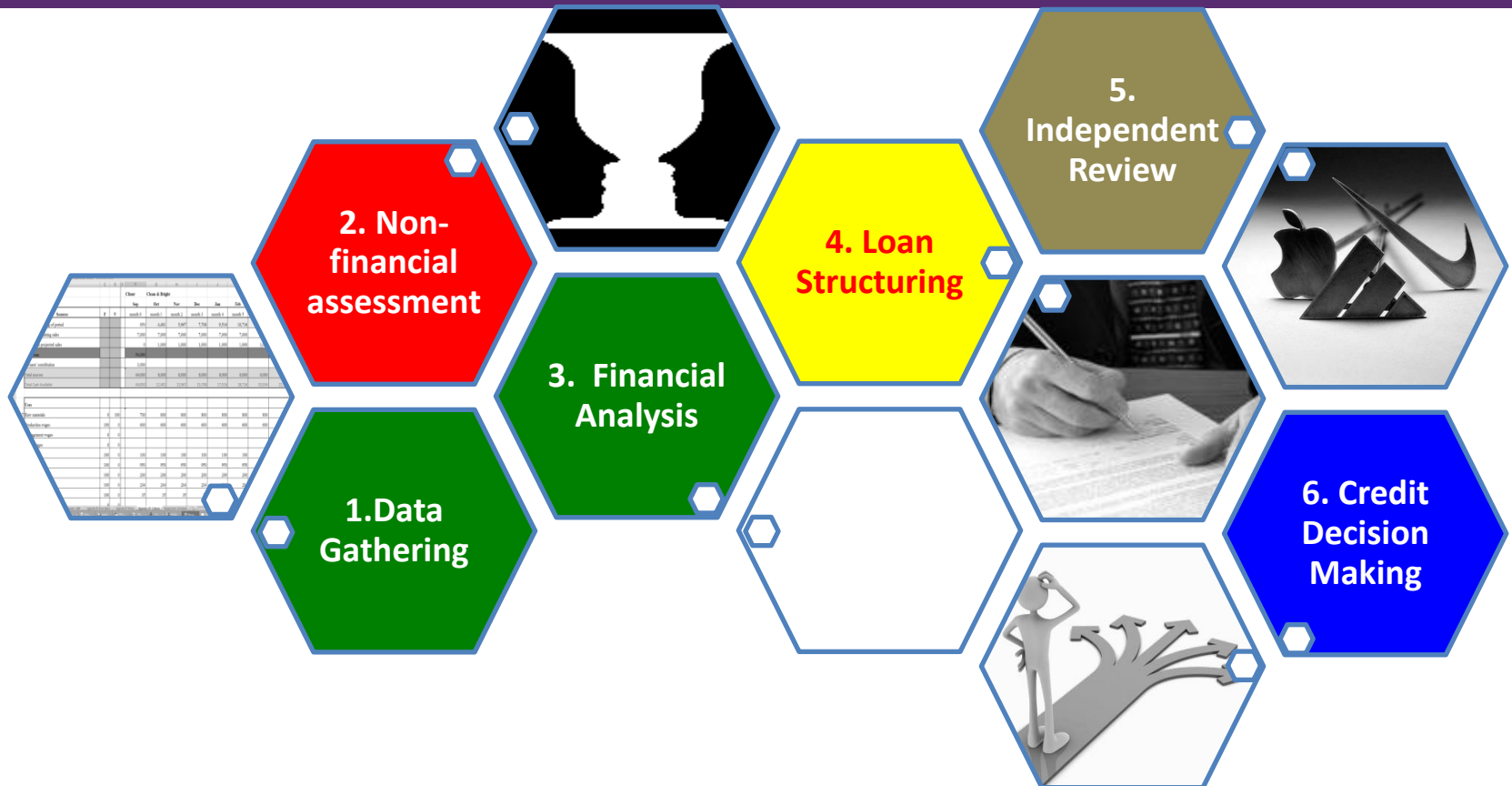
Monitoring

- Un-clear guidelines
- Lack of supervision
- No documentation of observations

Loan Origination

- Establish Client Eligibility Criteria
- Check list of exceptions
- Have a list of documents required
- Explain clearly the loan process

Risk Mitigation: Underwriting



Adopt Cash Flow Based Lending Approach

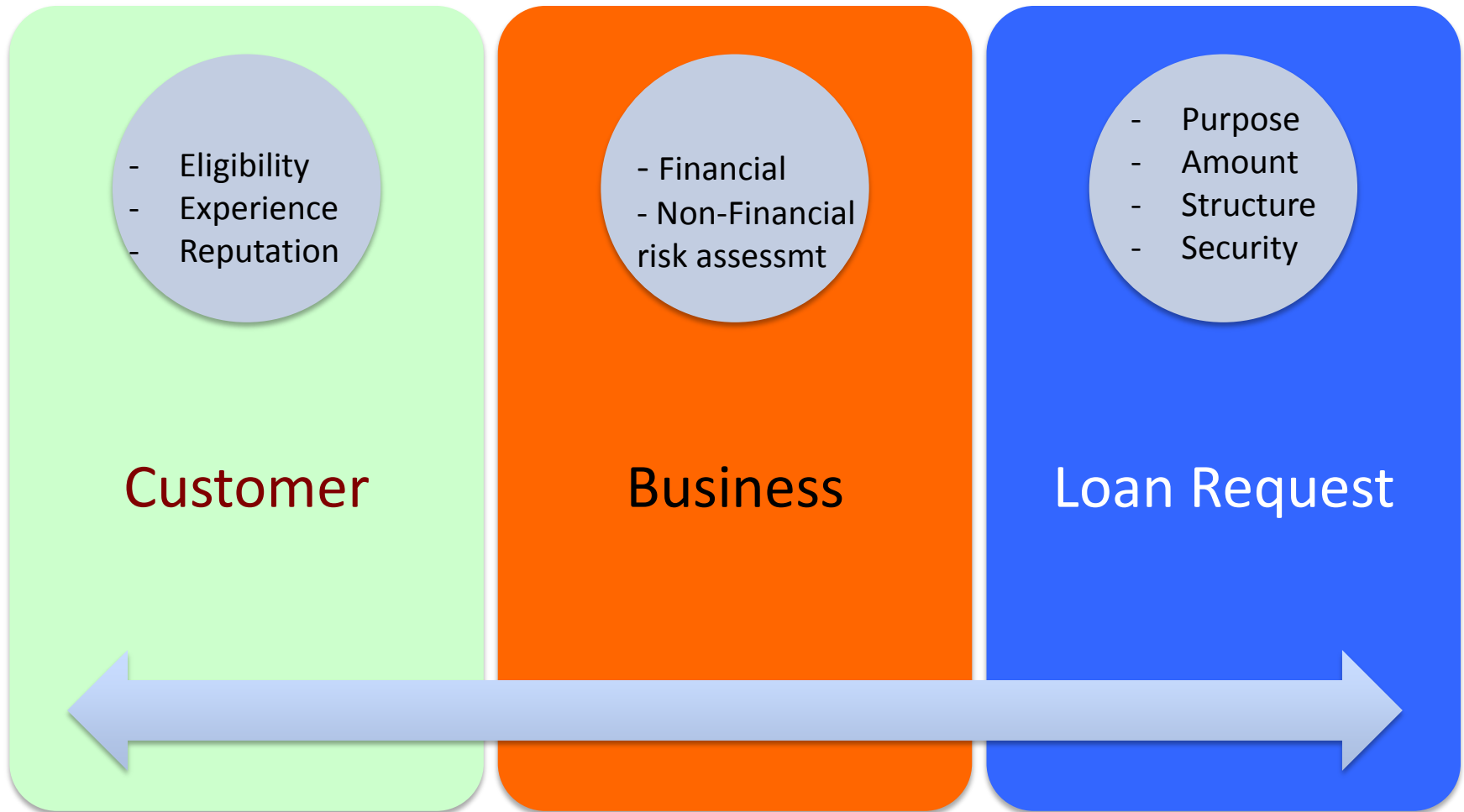
About Cashflow-based Approach

- Identifying sources and uses of cash
- Understanding cash flow seasonality
- Separating business cash from household cash
- Knowing how much cash is available for debt servicing (loan repayment)
 - *This is the basis in determining how much loan to give-not the collateral value*

Cashflow Analysis

- For short term loans (below 1 year term)
 - *Daily, weekly, monthly cash flow*
- For long term loan (> 1 year term)
 - *minimum of 12 months*

Risk Mitigation: Loan Approval



Risk Mitigation: Credit Scoring

- Credit score – represents an assessment of the creditworthiness of a person, or the likelihood that the person will repay a loan.
- Credit scoring models are intended to complement and facilitate the work of loan officers by supporting assessment of willingness and ability to pay.

Score inputs

- Socio-demographic data
- Behavioral data
- Credit bureau data

- Credit score cards are used to generate forecasts of future customer behavior.
- Basic principle is to assign a score or rating to an individual/business based on information available during the application process
- Decision is based on the same information used by a loan officer, but exhibits more consistent behavior.
- The score is taken as an indication of future behavior i.e. the higher the score the lower the risk and the greater the possibility the applicant will be profitable. (SEE SAMPLE SCORE CARD)

Example of a score card

20-29	- 7	3 +	0
30-34	0		
35-39	+ 5	Employment status	
40-55	+ 15	Full-time employed	0
56 +	+ 27	Part-time employed	- 23
		Self employed	- 11
Residential status		Homemaker	- 21
Home owner	+ 46	Student	- 48
Renting	- 12	Unemployed	- 85
living with parents	0		
		Time in current employment	
Time at current address		<1 year	- 68
<1 year	- 70	1-2 years	- 19
1-2 years	- 25	3-4 years	0
3-5 years	- 9	5-6 years	0
6-9 years	0	7-10 years	0
10+ years	+ 10	11-15 years	+ 7

Credit scoring

- Points are assigned by taking the constant as the base score ,then adding or subtracting the scores for each attribute.
- Consider the following applicant-
 - 38 years old
 - Home owner
 - Married with 2 children
 - Self employed for the last 2 years
 - Has a credit card
- The resultant score is then considered against a pre determined range .This range is set based on a through analysis of existing portfolio and called the acceptance cut off strategy e.g
 - Decline if scores at or below 879
 - Accept if scores at or above 880
- Advantage is that the score is not based on any single parameter

PART 111

Micro Savings



Micro Savings: Creating a Fallback

Micro Savings

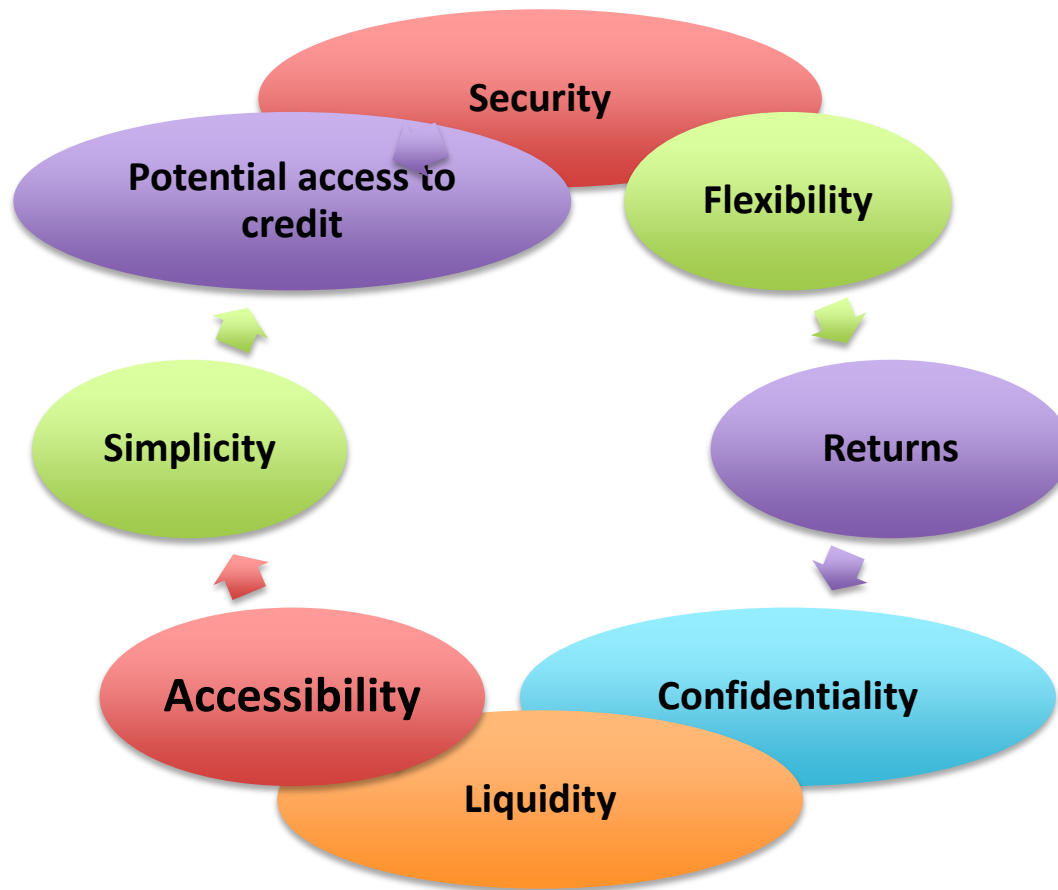
Benefits

- Asset build up for the economically poor people
- Source of low cost capital for financial institutions
- Partially covers security for loans obtained

Drivers of choice in service provider

- safety and security of their savings
- easy and immediate access
- a positive real return

What do Micro Savers want?



‘Field reports’

- Clients value two aspects of the service most highly: convenience, and their interactions with a particular individual.
- Convenience relates to: the ability to deposit daily or on a schedule that suits the client; the fact that the collector comes to the client; and the speed of transactions (three minutes on average).
- Clients appreciate that savings collectors come from the area, speak the local language, and demonstrate “the qualities of a good person.”

Source: CGAP, Country Level Savings Assessment, 2005.

Micro Savings: Approaches

- Attached to micro loan
- Voluntary, Mandatory
- Purpose-driven
- Profile of Target Clients (Age, economic activity)
- Client Preference
- Seasonal Promotions

Micro Savings Generation in Other Countries

Philippines

- Savings + loan installment paid together
- Kids and women use savings boxes or cans
- Special Promotion i.e., Raffle Draw



Micro Savings Generation in Other Countries

UML – Field based Account Opening



Micro Savings Generation in Other Countries

Equity Bank - Mobile Banking

taking banking services to the people
- 56 village mobile banks (rural focus)



Watch Out! – Savings Are Not Free Money

How to Minimize Cost

- Lean structure, simple offices, use ATMs
- Computerize operation
- Combine loan collection and deposit taking
- Give incentives for efficiency
- Adopt good Liquidity Management System

Source: CGAP- Comparative Analysis of Savings Mobilization Strategies

Risks in Micro Savings

- Accepting “Dirty Money”
- Dealing with Fraudsters
- Internal Mishandling
- Robbery in the field
- Regulatory Sanctions

Micro Savings: Mitigating Risks

- “Know Your Customer”
- Follow Prudential Norms in Liquidity Management
- Put in place robust Internal Control System
- Provide insurance coverage for field collection (loan payments and savings deposits)

Building your brand

- **Excellent customer service:** exceed customer expectations
- **Market driven services:** product terms should reflect market demand and services should be available in convenient locations at convenient hours without long waits
- **Governance:** should be governed by people who are known, respected and knowledgeable
- **Professional Management:** Promote managers whom clients will perceive as strong, risk conscious & trust worthy
- **Physical evidence:** Secure, attractive and professional appearance
- **Carefully designed promotion:** Send the right message

Key points

1. While credit funds come from investors, lenders and donors, deposits belong to clients – proper governance is vital
2. To succeed in Savings Mobilisation, the MFI must be trusted .Savings mobilization is much more complex than administering a credit-only program.
4. Savings products must be demand driven
5. The MFI must understand the real costs involved in savings mobilisation

Banking on Women

Advantages of banking women:

- New and largely untapped market
- Tend to save more regularly and reliably
- Less mobile than men
- Seek to meet their children's needs
- Less likely to resist loan repayment
- More able and willing to work in groups
- More likely to engage in micro enterprises
- Have less knowledge of finance and are more likely to be loyal to one provider

Remedial Management: Problem Loan Management

Call Out
Why do loans go bad?



Micro Loans: Internal Key Risk Drivers

- Too much pressure for disbursement
- Faulty incentive scheme
- Short-cuts in the loan process
- High staff turnover
- No monitoring visit
- Fraud

Micro Loans: External Risk Drivers

- Un-favorable regulations
- Un-healthy competition
- Diversion of funds by customers

Understanding Delinquent Clients' Behaviour



**Cannot Pay
But Wants To**



**Can Pay
But Does
Not Want
To**



**Cannot Pay
and Never
Will**

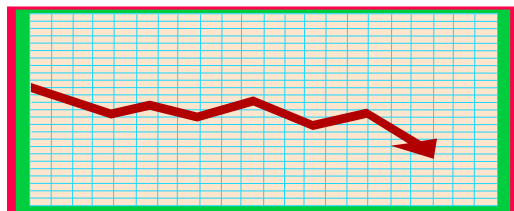
Course of action varies for each type of Behaviour!

Impact of Problem Loans

The impact of delinquency & default!!

Direct costs

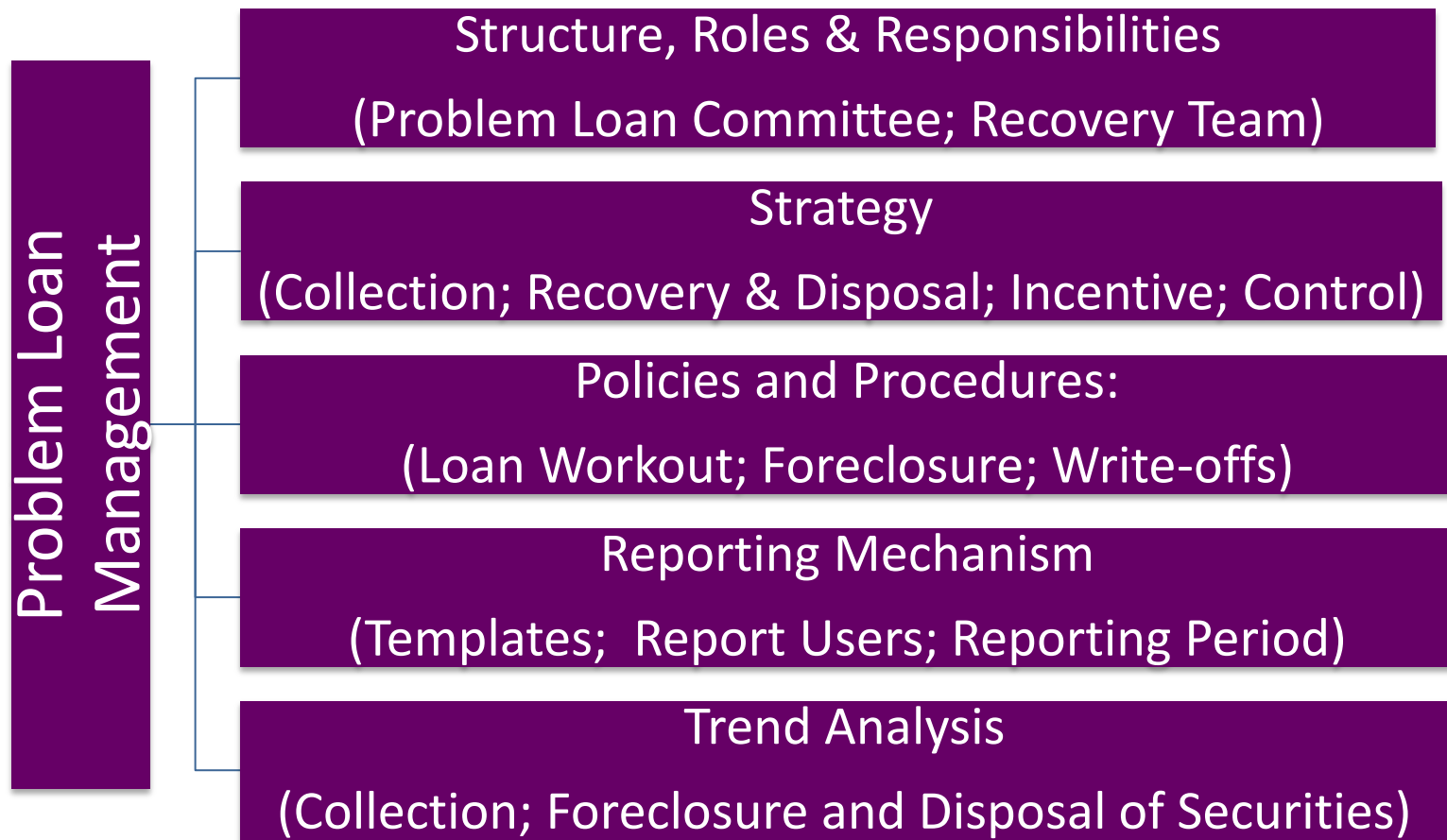
- Cash shortfall
- Increase in cost of funds
- Interest income foregone
- Potential loss of savings deposits
- Increase in loan loss reserve and loan loss provisioning



Indirect costs

- Time spent managing problem loans rather than on developing new business
- Decreased staff motivation
- Negative signal to other borrowers
- Loss of reputation
- Inability to raise capital
- Decrease in loan officer incentives

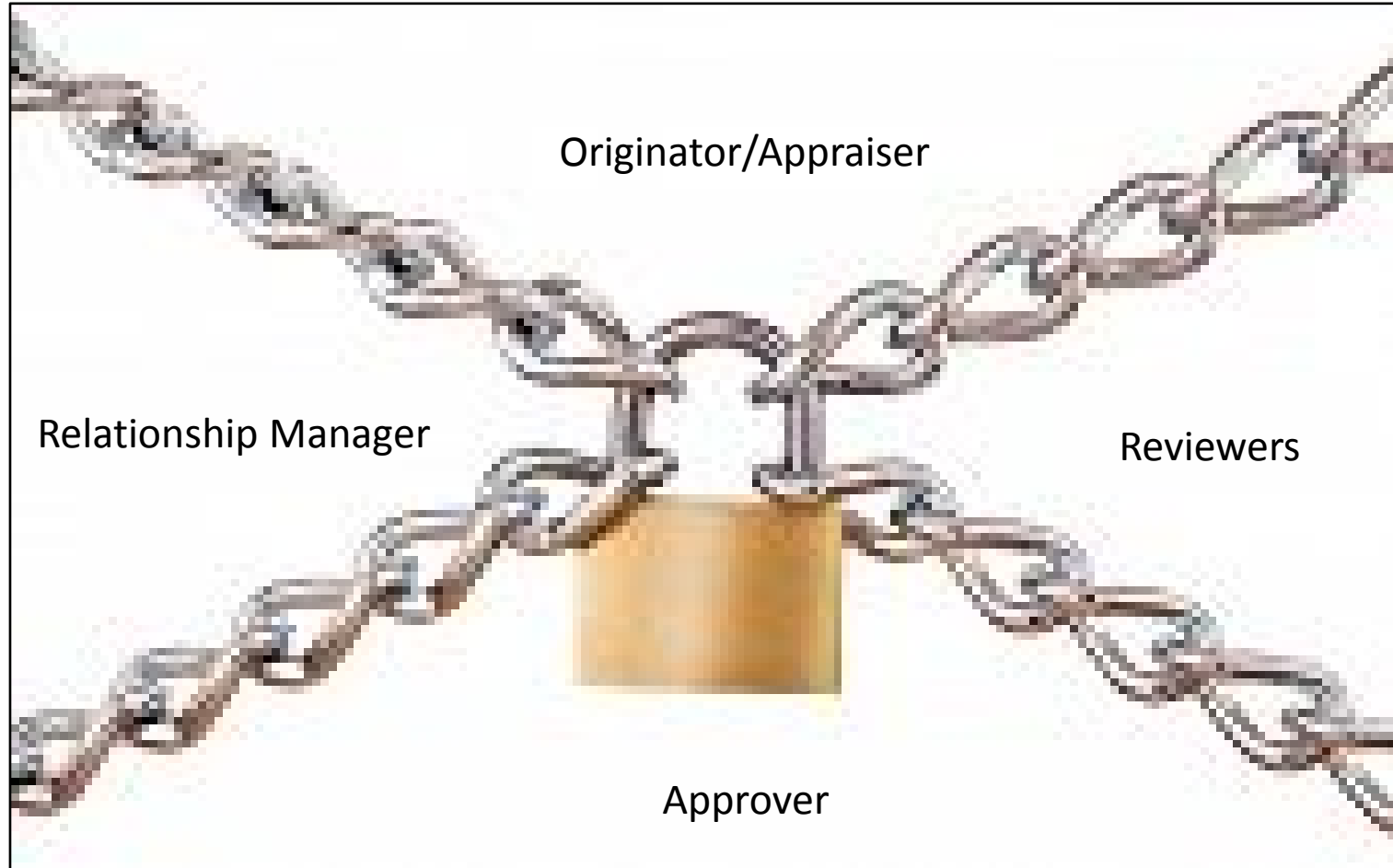
Problem Loan Management: Sample Framework



Problem Loan Management: Structure

- Centralized versus Decentralized
 - Best Practice is a mix
 - Example:
 - Nigeria
 - Jordan
- Crisis Situation
 - Philippines

Portfolio Quality: Who is Accountable?



**END
SECTION**