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Linkages between Loan Award Criteria, Credit Recovery Performance and Survival of Micro Finance Banks in Delta State, Nigeria

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ABSTRACT

Analyzing loan management techniques loan and its effect on recovery performance is central to the sustenance of Micro finance institutions. The main objective of this study was to assess the linkages between loan award criteria, credit recovery performance and survival rate of micro finance bank in Delta State. To achieve the objectives, secondary data were collected from the micro finance banks in Delta State. Data obtained from the field were subjected to statistical analysis using appropriate descriptive statistical tools (mean, percentage) and inferential statistics (simple regression model). Analysis was done on the average amount of loan disbursed to applicant, average amount of loan repaid, loan recovery performance, the relationship between credit award criteria (principal balance) on performance recovery the rate of survival of the bank. This was achieved using agricultural loan at risk portfolio from across the branches from January 2013 to December, 2015. The study revealed that the average amount of loan disbursed to borrowers was ₦153,718.80, average amount repaid was ₦84,564.69, overall loan recovery performance was 55% and the rate of survival was 7%. The test of hypothesis showed that there is positive and significant relationship (P<0.05) between principal balance and loan recovery performance (0.60) and borrower status (0.84). It is recommended that since principal balance is an effective loan management technique, it should be adhered to by all micro-finance banks.

KEYWORDS: Linkages, Loan, Criteria, Survival, Micro-Finance.

INTRODUCTION

The concept of credit can be traced back to history and it was not appreciated until and after the Second World War when it was largely appreciated in Europe and later to Africa (Kiiru, 2007). Economic boom in USA in 1885 when the banks had excess liquidity and wanted to lend the excess cash (Ditcher, 2003) made credit policies and practices popular.

In Africa the concept of credit gained popularity in the 1950's when most banks started opening the credit sections and departments to give loans to white settlers.

Microfinance Institution may be defined as any financial institution which offers not only small loans to microenterprises, Small and Medium Enterprises, 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 fulfill 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 negative impacts on MSMEs financing. Microfinance institutions all over the world including Ghana are faced with the challenge of loan default/delinquency.

There is high probability of credit recovery risk among microfinance institutions (MFIs) because most microloans are not secured (Warue, 2012). The success of MFIs largely depends on the effectiveness of their credit management systems because these institutions generate most of their funds from interest earned on loans extended to small and medium entrepreneurs. The Central Bank Annual Supervision Report, (2010) observed a high incidence of credit risk reflected in the rising levels of non-performing loans by the MFI's in the last 10 years. This has adversely impacted on their profitability and survival. This trend has threatened the viability, sustainability of the MFI's and the achievement of its primary goal of serving the financially excluded population. A Study on microfinance credit recovery systems in Nigeria is worthy of investigation. However, most of the similar studies undertaken in the past few years have focused mainly on credit models used by MFI's and their impact on profitability (Migiri, 2002). Although other researchers have investigated the effect of loan management techniques on loan performance such as collateral attached as security (Pruit and Gitman, 1991; Moti, et. al. 2012), history of repayment of the customer, (Anthony, 2006; Moti *et. al*. 2012), cash flow statements of the business, size of business (Macharia, 2000; Moti, *et. al*. 2012), signing of covenants, financial condition of the business, stringent policy (Moti, *et. al*. 2012). There is still a gap in empirical studies on credit recovery systems and the survival of MFIs. Considering the critical role that MFIs play in the economy, the principal motivation behind this study was to find out the linkages between loan award criteria and loan recovery performance of Micro Finance Bank.

The overall objective of the study was to assess the loan management techniques of Micro Finance Bank and its effects on repayment performance. The specific objectives of the study were to;

i. assess the average amount of loan disbursed to applicants.
ii. determine the average amount of loan repaid.
iii. ascertain the recovery performance of micro finance bank.
iv. evaluate the effect of credits award criteria (principal balance) on recovery performance.

The study is significant by analyzing loan recovery performance and survival of micro finance banks. It therefore established the centrality of appropriate loan management techniques in the sustenance of Micro finance banks.

MATERIALS AND METHODS

The study was conducted in Delta state, Nigeria. This location was chosen for the study due to the importance of micro finance banks in the economy of Delta state. The population for this study was made up of all the 74 microfinance banks in Delta State. The sample of the study comprised of Delta State Micro finance bank. This bank was chosen for the study due to its large number in Delta state. Annual loan disbursement portfolio was collected from the banks from 2013 – 2015. This gave a total of 3 years annual loan disbursement. Secondary data was used for the study. It was collected from the bank. Information was sought on the total amount of cash disbursement for each year and the rate of loan recovery. Data obtained from the bank records were subjected to statistical analysis using appropriate statistical tools. Objective 1: Average amount of loan disbursed and objective 2: Average amount of loan repaid, were achieved using descriptive statistics (means, frequency distribution and standard deviation).

Objective 3: loan recovery performance, was obtained using the formula below;

$$\%\ \textbf{loan recovery performance} = \frac{\textbf{amount of loan recovered}}{\textbf{amount of loan disbursed}}\ \textbf{x}\ \frac{\textbf{100}}{\textbf{1}}$$

The causal effect of credit award criteria (credit management techniques) on loan recovery performance of micro finance banks was evaluated using Ordinary Least Square techniques of multiple regressions. The model is specified as:

$$\mathbf{L_{rp} = B_r + B_1CRWT + \mu}$$

Where;

L_{rp} = Loan Recovery performance (%)

CRWT = Credit Worthiness of Client (principal balance)

B_r = Constant

B_r = Coefficient parameter estimate

μ = Error term

RESULTS AND DISCUSSION

$$\textbf{Average amount of loan disbursed} = \frac{\textbf{amount of loans issued}}{\textbf{number of loan applicants}}$$

$$= \frac{\textbf{₦11,374,822.24}}{\textbf{74}}$$

$$= \textbf{₦153,718.80}$$

The average amount of loan disbursed to customers by the bank was ₦153,718.80. This shows that the customers received an average amount of ₦153,718.80 from 2010 to 2014.

Mean amount of loan recovered by the micro-finance bank was evaluated as:

$$\textbf{Average amount of loan recovered} = \frac{\textbf{amount of loans recovered}}{\textbf{number of loan awardees}}$$

$$= \frac{\textbf{₦6,257,034}}{\textbf{74}}$$

$$= \textbf{₦84,564.69}$$

The average amount of loan recovered was ₦84,564.69. This showed that out of the money disbursed (₦153,718.80) by the bank only ₦84,565.69 was repaid by the customer. This has resulted to losses on the part of the financial institution because of high rate of default. According to Warue, (2013) the chances that Micro Finance Institution (MFI) may not recover its Money plus interest from borrower is the most common and often most serious vulnerability in a microfinance institution.

$$\textbf{Loan recovery performance} = \frac{\textbf{Average amount of loans recovered}}{\textbf{Average amount of loans disbursed}} \textbf{ x 100/1}$$

$$= \frac{\textbf{₦84,564.69}}{\textbf{₦153,718.80}} \textbf{ x 100/1}$$

$$= \textbf{55}\%$$

The finding showed that 55% of the loan issued was recovered while 45% was not recovered. The implication finding is that the degree of loan leakages (45%) is relatively high among micro-finance banks. This has the tendency of reducing available funds for future loan administration. Loan leakages has a dual adverse effects on future loan applicants and sustainability of micro-finance institutions. Therefore, loan leakages have the tendency to discourage loan supply and demand in an economic system. According to the finding of this study, effort must be intensifying on loan recovery drive. This finding corroborates the earlier report of Modurch (1999), who reviewed that in 1990 loan given to customers did not perform due to leakages. The author further emphasized that since most micro loans are unsecured, default/delinquency 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 sector. Consequently, many clients may be exposed to the same external threats such as lack of demand for client, products, livestock, disease outbreak, bad weather and many others. These factors create volatility in micro loan 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 repayment rate before it gets out of hand.

Table 1 shows that there is positive and significant correlation ($P<0.05$) between principal balance and amount of loan recovered (0.60). This means that if the micro finance banks adhere to the criterion of principal balance in loan management, loan recovery performance will improve significantly. Tentatively when there is default, the bank will fall back to the customer principal balance in other to recover their capital and interest. In line with the findings of Anthony (2006), this study found significant relationship between capacity of the client to repay and loan performance

Table 1. Pearson Correlation Matrix showing the Relationship between credit award criteria and loan recovery performance

Variables	Recovered Loan	Principal Balance in Account	Status of money Borrowed
Recovered Loan	1.00	0.60	0.26
Principal balance in Amount		1.00	0.84
Status of money borrowed		.	1.00

Test of Hypothesis: H_0: There is significant relationship between credit award criteria and loan recovery performance of Micro finance bank.

The study further demonstrated that principal balance has positive and significant ($p<0.05$) relationship with the status of borrowed funds (0.84) (Table 1). This result implies that principal balance of a borrower (client) can be used to predict, with relative accuracy, the status of borrowed money. Higher principal balance of the borrower can significantly secure borrowed funds in micro-finance institutions. The survival of Micro- Finance Banks can therefore be hinged on the principal balance of clients. In the present study, 7 out of 74 branches of the surveyed Micro-Finance Banks adhered strictly to sufficient principal balance as loan award criterion and these are the few branches that are likely to survive or remain in operational existence in the future. Other branches are likely to go into bankruptcy unless an intervention scheme or bailout mechanism is mounted to salvage them.

CONCLUSION AND RECOMMENDATIONS

Micro finance bank is likely to phase out if they do not adhere to the appropriate loan management techniques practices. Microfinance bank loan management performance is low and has resulted to high rate of loan default. If they adhere to the appropriate loan management technique (principal balance) they are likely to survive.

It is recommended that since principal balance is an effective loan management technique, it should be adhered to by all micro-finance banks.

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