DETERMINING THE CAUSES AND IMPACT OF NON PERFORMING LOANS ON THE OPERATIONS OF MICROFINANCE INSTITUTIONS : A CASE OF SINAPI ABA TRUST.

By

ARKO, SAMUEL KOFI

(PG 4092610)

A Thesis submitted to the Institute of Distance Learning, Kwame Nkrumah University of Science and Technology in partial fulfillment of the requirements of the degree of

COMMONWEALTH EXECUTIVE MASTERS OF BUSINESS ADMINISTRATION

SEPTEMBER, 2012.

DECLARATION

I hereby declare that this submission is my own work towards the award of Commonwealth Executive Masters in Business Administration (CEMBA) and that to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University except where due acknowledgement bas been made in the text.

Arko, Samuel Kofi (20134773)	……………………..	………….
Student Name & ID	signature	Date

Certified by:

JONATHAN WELBECK	………………………	……………….
Supervisor	Signature	Date

Certified by

Prof. I.K. DONTWI

Dean, IDL	…………………..	…………………
	Signature	Date

DEDICATION

This work is dedicated to my dear wife, mother and children.

ACKNOWLEDGEMENT

I would like to express my profound gratitude to Almighty God for the strength and life given to me to undertake this research work. I am also thankful to all those who in one way or the other contributed in the successful completion of this work. My heartfelt gratitude goes to Mr. Jonathan Welbeck;(Bank of Ghana) my project supervisor and lecturer for his directions, suggestions, pieces of advice and sharing of knowledge to make this project a success. My gratitude also goes to Abraham Kwasi Gyan of ADB for his useful suggestions and encouragement in the face of difficulties and challenges in the course of this project work. I cannot fail to acknowledge the support and contribution of Messrs Akuoko(Sinapi Aba Trust, Dworwulu) and Mr. Emmanuel Damoah(Sinapi Aba, Mankessim branch) in making this work a success.

Finally, I am eternally grateful to my wife; Mrs Elizabeth Arko for her support, sacrifices, encouragement and understanding in the course of undertaking this project work.

ABSTRACT

Microfinance Institutions (MFIs) in Ghana currently provide significant financial services including microcredit facilities particularly to the rural and semi-urban areas across the country. Granting of microcredit facility(Loan) is a major activity of the MFIs and the loan portfolio constitute a significant proportion of the assets of the MFIs. Undoubtedly, the MFIs derive most of their interest incomes from loans, however, not all loans granted to beneficiaries perform well and earn the expected returns and this tend to have adverse effect on the quality of the loan portfolio. In the light of key role that the MFIs have assumed in the national economy, the study was conducted to establish the causes, trend and impact of NPLs on the operations of MFIs with particular focus on Sinapi Aba Trust(SAT). The study specifically focused on the impact of NPLs on operating profits, interest incomes and loanable funds of SAT. In terms of data, primary and secondary data were used for the study. The study found out that SAT recorded substantial amounts as non performing loans in the five-year period reviewed and this adversely affected the financial performance of the organization by way of reducing its operating profits, loanable funds and undermining the liquidity position among others. Business failure, lack of monitoring of loans, inadequate marketing avenues were identified as the principal causes of the non performing loans in the organization. The study also found that trade and service sectors have the highest incidence of NPLs. In order to address the menace of NPLs in the MFIs, the following measures are recommended to the management of (SAT). These measures include effective monitoring of loans, credit training programs, tight security requirements and seeking the services of credit reference bureaus and private debt collectors.

TABLE OF CONTENTS

CHAPTER TWO: LITERATURE REVIEW

CHAPTER THREE: RESEARCH METHODOLOGY

CHAPTER FOUR:

ANALYSIS, DISCUSSION AND PRESENTATION OF RESULTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE:

1.0 Introduction:

This introductory chapter of the study will be composed of background of the research, research problem, research objectives, research questions, significance of the research, scope and limitations of the research and the organization of the research.

1.1 Background to the study

Extension of credit facilities is one of the major activities of all Microfinance institutions including Savings and Loans Companies, Rural banks, Financial Non Governmental Organization(FNGOs) and credit Unions. This is usually evidenced by the large proportion that loans constitute in the overall operating assets of these lending institutions. Healthy loan portfolios are therefore vital for lending institutions in view of their impact on Liquidity, lending capacity, earnings and profitability of the MFIs. Microfinance Institutions (MFIs) currently provide financial services to an estimated 15 percent of the country's total population as compared with 10 percent for the commercial banking sector.(J.Obuobi and G. Polio, 2010).

Some of the loans given out by the lending institutions unfortunately become non performing and eventually result in bad debts with adverse consequences for the overall financial performance of the institutions. The issue of loan default(NPLs) is becoming an increasing problem that threatens the sustainability of MFIs. The causes of the problem are multi-dimensional and non uniform among different literatures.

NPLs are always a source of misery for lenders because if an MFI has too much of it on its balance sheet, it can adversely affect its operations in terms of liquidity, profitability, debt- servicing capacity, Lending capacity and ability to raise additional capital. The incidence of non-performing loans in the Ghanaian banking and non-banking industries including MFIs has been on the rise in recent years as their loan portfolio increases despite efforts by these financial institutions to deal with it.

Sinapi Aba Trust is one of the leading microfinance institutions facing the challenge of a growing non- performing loan portfolio with its attendant harmful effect on the operations of the institution and the situation calls for remedial measures to curb it. The study therefore focuses on identifying the causes of non performing loans, the implications of NPLs on the operations of MFIs and the strategies to reduce the incidence of NPLs.

Specifically, the project would identify underlying reasons for non-performing loans at Sinapi Aba Trust, determine the trend of the incidence of NPLs in SAT, the impact of NPLs on Interest income, the impact of NPLs on operating income and the impact of NPLs on loanable funds. Again, it will be the objective of the study to examine the sectoral distribution of NPLs and the also come up with implementable strategies to address some of the causes of the incidence of non performing loans. The financial sector (Banking and non banking)plays a very important role in every economy. There is evidence to suggest that well functioning lending institutions help to accelerate economic growth and conversely, poorly functioning ones impede progress and aggravate poverty (Barth et al., 2004). A key function of most banking and Microfinance institutions is lending with interest incomes on loans and advances constituting a large source of revenue for these financial institutions. According to

GHAMFIN annual report(2008), the total NPLs of the MFI stood at 6% in 2004 and by 2006, it has shot up to 9%. With loans and Advances making over 50% of the total operating assets of MFIs, if the trend of the incidence of NPLs continues, it will have a huge negative impact on the operations of the MFIs in Ghana. This issue has gained increased attention in recent years because of its adverse effects on the banking and non banking financial institutions and the country's economy as a whole. The immediate consequences of non performing loans are the reduction in profitability through disposal costs like provisions for credit losses and direct write-offs for bad debts and shrinking of loanable funds. Large amounts of non-performing loans in the banking and non banking financial system have at many times threatened the failure and actually collapsed many banks and microfinance institutions. Many researches on the causes of bank failure show that poor quality of loan portfolio is statistically a major predictor of insolvency (e.g. Dermigue-Kunt, 1989; Barr and Siems, 1994) with failing banks usually having high levels of non-performing loans prior to failure. Capario and Klingebiel (1996) indicated that non-performing loans represented 75% of total loan assets in Indonesia, which led to the collapse of over sixty banks in 1997. Banks and microfinance institutions in Ghana are not insulated from the problem of delinquent loans.(Non performing loans)

1.2 Problem Statement

Loan portfolio constitutes the largest operating assets and source of revenue of most financial institutions'. However, some of the loans given out become non-performing and adversely affect the profitability and overall financial performance of the lending institutions. Many lending institutions in Ghana are confronted with the challenge of rising non-performing loan portfolios despite efforts at stemming the tide. SINAPI ABA TRUST is one of the pioneering Microfinance institutions with a deteriorating trend in the health of their loan portfolio in recent years; the FNGO's annual reports show that non-performing loan ratio went up from 1.5% in 2006 to 2.8% in 2007 and by the year 2009, the NPL ratio has reached 4.3% after a slight dip in 2008. The situation calls for an effective strategy to remedy it before it gets out of hand and this research work seeks among other objectives to come up with recommendations that will help arrest this deteriorating trend or at least help reduce the rate of loan default in MFIs.

1.3 Objective of the study

The general objective of the study is to identify the major causes of non performing loans in the microfinance institutions in Ghana. Specifically, it is aimed at:

- Determining the trend of incidence of NPLs in a selected MFI.
- Assessing the impact of NPLs on Interest income, Operating profit and Loanable funds.
- Identifying factors accounting for the incidence of non-performing loans in Sinapi Aba Trust.
- Identifying the sector with the highest incidence of NPLs
- Recommending strategies that effectively address the problem of non-performing loans in the MF institutions.

1.4 Research Questions

The research work seeks to find answers to the following questions:

1. What are the causes of the incidence of NPLs in Sinapi Aba Trust.?
2. What effect does the incidence of NPLs have on interest income, operating profit and loanable funds?

3. What has been the trend of NPLs in the selected institution in the last five years.?
4. Which areas(sector of the economy) of lending has seen the highest default rate.?

1.5 Significance of the study

The loan portfolios of the lending institutions are major assets that generate a significant amount of interest income. It play a critical role in determining the financial performance of the MFIs and it can therefore be said that the healthier the loan of the MFI, the better its financial performance will be. In the light of the importance of the health of the loan portfolio, it is essential that a study be conducted to identify the problems that negatively affect the performance of the MFIs. The outcome of this project would enable SINAPI ABA TRUST adopt workable strategies to control the problem of a growing non-performing loan portfolio in the institution and thereby improve its financial performance and profitability.

Secondly, the project would be of benefit to the Ghanaian banking and non-banking financial sectors as a whole since the financial(Lending institutions) in the country operate within the same environment and deal with customers of similar characteristics.

Thirdly, the project could serve as a source of reference for other related research works in the future.

Thus , the study would contribute immensely to the development of microfinance sector which play a significant role in the economy. This is because notwithstanding the challenges, microfinance has emerged globally as one of the effective strategies in poverty reduction with the potential for far-reaching impact in transforming the lives of the poor people.

1.6 Scope of the Study

The study focuses on the non performing loans in the Microfinance institutions in Ghana with particular focus on SAT. Thus, the project seeks to establish the causes of poor loan repayment performance by the beneficiaries of Sinapi Aba Trust. The reason for limiting the scope to SAT is that it is one of the MFIs which has been contributing significantly to expand the frontiers of microfinance operations in Ghana since 1994. It possesses all the unique characteristics of Microfinance institutions, engages in almost all the activities undertaken by the other MFIs in the country and also they are located in almost all the ten regions in Ghana. Additionally, microcredit activities of SAT covers several sub- sectors of the economy which makes it a model microfinance institution and therefore a suitable MFI which could be studied and the findings reasonably generalized as what pertains in other MFIs in Ghana. Generally, this research work looks at the various classes of bad loans, the possible causes of bad loans, the impact of bad loans on the operations of SAT and the sectors with the highest default rate. The period of assessment has also been limited to 2006-2010. This is to ensure that the result reflects the current trend in the operations of SAT.

1.7 Limitations of the Study

Among the major constraints in this study was time. Looking at the short period required for the completion of the work, the case study approach was adopted. Even though the MFIs in the country share common characteristics and face similar challenges, there is still the possibility that some aspects regarding the topic may not be discussed if those aspects are peculiar with the MFIs that are not covered in the study. This is main reason why SAT which has operated in the country for over 16 years with all the typical characteristics of MFI was chosen for the study. A sample and not the entire population of credit staff and branch managers of the institution were interviewed or administered with questionnaire to obtain the primary data. This obviously imposed some limitations on the study. In addressing this limitation, an objective questionnaire and interview guides were designed for the respondents in order to reduce sampling error. Again, another limitation was access to information as not much research has been done with regards to MFIs. Most financial institutions will not readily disclose information to researchers for fear of breach of Oath of Secrecy(Duty of confidentiality). This constraints was dealt with by relying on published annual reports and financial statements and also assuring the respondents that the information was mainly for academic purposes and that their identities will not be disclosed anywhere.

1.8: Organization of the Study

The study is organized into five chapters. The first chapter is made up of the background of the study, the statement of the problem, the research questions, objectives of the study, the significance of the study, scope and limitation of the study and the organization of the study. Chapter two reviews literature on the Evolution of microfinance sector, definitions and causes of NPLs, performing and NPLs, Loan classification and provisioning, implication of NPLs for MFIs, Reducing the incidence of NPL and the challenges facing microfinance schemes, The institution on which this project is based is SINAPI ABA TRUST. Data for the work would therefore be obtained from sources such as the organisation's financial statements and annual reports, credit policy manual and other pertinent documents. Additionally, interviews would be conducted with, and questionnaires administered to relevant persons within the institution. Data obtained would be analysed using both qualitative and quantitative methods.

Chapter three describes the research methodology and profile of study area. Here, the target population, the sample size and sampling technique, the research instrument and data collection procedures are outlined. The data analysis, interpretation, and discussions are contained in chapter four. Chapter five provides the summary, conclusions and recommendations of the study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews the existing literatures related to the research problem and it is sub-divided into headings: Evolution of micro finance sub-sector, Various categories of Microfinance institutions in Ghana, Performing and non performing loans in MFIs, Classification and Provisioning, Microfinance and development, Implication of NPLs, Causes of NPLs, Reducing the incidence of NPLs and the Challenges facing micro finance institutions in Ghana.

2.1. Evolution of the Microfinance Sub-Sector in Ghana

With almost thirty per cent of Ghanaians living below the poverty line, microfinance has been identified as an important means of providing financial services to the population. It is therefore not surprising that the country's present and past governments have perceived microfinance as central to achieving the greater goal of poverty reduction. Through microfinance, the various governments have aimed to provide the poor, who do not have access to the formal financial sector, with greater access to customized financial services.

The Government of Ghana is committed to the goals of the Millennium Development Goals and one of the strategies is the building of a robust and sustainable microfinance industry which addresses poverty reduction, women's empowerment and household welfare. Micro-entrepreneurs constitute about 66% of the labour force in the country and, thus, represent a vital economic force.(Adjei, 2010) Increasing the access to financial services by this group deepens the financial sector and also links them to the economic mainstream. Indeed, the concept of microfinance is not new in Ghana. There has always been the tradition of people saving and /or taking small loans from individuals and groups within the context of self-help to start businesses or farming ventures. For example, available evidence suggests that the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries. However, Susu, which is one of the microfinance schemes in Ghana, is thought to have originated from Nigeria and spread to Ghana in the early twentieth century.

Over the years, the microfinance sector has thrived and evolved into its current state thanks to various financial sector policies and programmes undertaken by different governments since independence. Among these are:

- Provision of subsidized credits in the 1950s;
- Establishment of the Agricultural Development Bank in 1965 specifically to address the financial needs of the fisheries and agricultural sector;
- Establishment of Rural and Community Banks (RCBs), and the introduction of regulations such as commercial banks being required to set aside 20% of total portfolio to promote lending to agriculture and small scale industries in the 1970s and early 1980s;

- Shifting from a restrictive financial sector regime to a liberalized regime in 1986;
- Promulgation of PNDC Law 328 in 1991 to allow the establishment of different categories of non-bank financial institutions, including savings and loans

companies, and credit unions.

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

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

In terms of the regulatory framework, rural and community banks are regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated under the Non-Bank Financial Institutions (NBFI) Law 1993 (PNDCL 328). The Bank of Ghana has since 2011 designed operational guidelines and licensing requirements to help streamline the operations of MFIs in the country.

2.1.1 Various categories of Microfinance Institutions in Ghana

The key stakeholders of Microfinance institutions in Ghana are the Rural /Community Banks, Savings & Loans companies, Credit Unions and Financial Non Governmental Organizations.

(i) **Rural Banks**

Rural Banks are unit banks which are owned and managed by residents in a community. They are registered under the Company's Code and are licensed by the Bank of Ghana to engage in the business of banking. Being unit banks, they are not allowed to open branches but are permitted to open agencies within their catchments areas for the purpose of mobilizing deposits. The basic functions of Rural Banks are the mobilization of savings and the extension of credit to deserving customers in their areas of operation. It is also the belief of the Central Bank that through their financial intermediation roles, Rural Banks will act as catalysts for economic development in rural Ghana.

(ii) Savings and Loans Companies

Savings and loans companies (S&Ls)are deposit-taking financial institutions regulated by the Bank of Ghana under the Non- Bank Financial Institution (NBFI) Law 1993 (PNDCL 328), with a minimum capital requirement much lower than that of the universal banks but above that for rural and community banks.

The advent of the NBFI Law gave rise to a rapid growth and transformation of some Financial Non Governmental Organisations (FNGOs) into savings and loans companies operating in urban and peri-urban areas in the country.

They serve mostly the economic active informal unbanked populations and offer tailored products to suit this category of the population. They are restricted to a limited range of financial services compared to universal banks, mostly mobilising deposit, provision of credit to low income clients and SMEs, money transfers and financial literacy. They utilise microfinance methodologies to serve most of their clients in the peri-urban areas with an average loan size higher than the other category of microfinance institutions.

(iii) Credit Unions

Credit unions are registered by the Department of Co-operatives as cooperative thrift societies in Ghana and are permitted to accept deposits and give loans to their members only. It is worth noting that the first Credit Union in Africa was established in the Northern part of Ghana in 1955 by the Canadian Catholic missionaries. Credit unions have an established association commonly referred to as CUA. The association serves as a self-regulatory apex body for its affiliates.

(iv) Financial Non Governmental Organizations.

Financial NGOs (FNGOs) are incorporated as companies limited by guarantee under the Companies Code. They are considered to be the semi formal system, in that they are formally registered, but are not licensed by the Bank of Ghana. FNGOs are mostly mission-driven, and are especially active in poor communities. Their poverty reduction focus leads most of them to provide multiple services including microcredit, which remains their main business, to poor clients though mostly on a limited scale. They are not allowed to take deposits from clients and hence have to use external funds for microcredit. These funds are mostly from donors, social investors and government programmes. Some of them however operate the susu scheme which allows individuals to save small amounts on a daily or weekly basis.

2.1.2 Microfinance and Development

Microfinance encompasses the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients. It includes loans, savings, insurance, transfer services and other financial products and services. Microfinance is thus one of the critical dimensions of the broad range of financial tools for the poor, and its increasing role in development has emanated from a number of key factors that include the fact that the poor need access to productive resources, with financial services being a key resource, if they are to be able to improve their conditions of life.

Studies have shown that micro-finance plays three broad roles in development:

- It helps very poor households to meet basic needs and protects against risks,
- It is associated with improvements in household economic welfare,
- It helps to empower women by supporting women's economic participation and so promotes gender equity.

The literature suggests that micro- finance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty. By providing material capital to poor persons, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Otero, 1999). The aim of micro-finance according to Otero (1999) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector.

Littlefield and Rosenberg (2004) argue that the poor are generally excluded from the financial services sector of the economy so MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to increase the number of poor people they can reach (Otero, 1999). Accomplished commentators such as Littlefield, Murduch and Hashemi (2003), Simanowitz and Brody (2004) have commented on the critical role of micro-credit in achieving the Millennium Development Goals.

According to Simanowitz and Brody (2004,) micro-credit is a key strategy in reaching the MDGs and in building global financial systems that meet the needs of most poor people." Littlefield, Murduch and Hashemi (2003) state "micro-credit is a critical contextual factor with strong impact on the achievements of the MDGs. Micro-credit is unique among development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale".

However, some schools of thought remain skeptical about the role of micro-credit in development. For example, while acknowledging the role micro-credit can play in helping to reduce poverty, Hulme and Mosley (1996) concluded from their research on micro-credit that "most contemporary schemes are less effective than they might be" (1996). The authors argued that micro-credit is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off.

This notwithstanding, microfinance has emerged globally as a leading and effective strategy for poverty reduction with the potential for far-reaching impact in transforming the lives of poor people. It is argued that microfinance can facilitate the achievement of the Millennium Development Goals (MDGs) as well as National Policies that target poverty reduction, women empowerment, assisting vulnerable groups and improving standards of living. As pointed out by the former UN Secretary General Kofi Annan during the launch of the International Year of Micro Credit (2005),

‘Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs." (Kofi Annan, December 2003).

Although microfinance is not a panacea for poverty reduction and its related development challenges, when properly harnessed it can make sustainable contributions through financial investment leading to the empowerment of people, which in turn promotes confidence and self-esteem, particularly for women and the vulnerable.

2.1.3 Microcredit and Microfinance

Microcredit

Microcredit is the provision of cash and in-kind loans in smaller amounts to micro and small entrepreneurs meant to improve their business operations.

Microfinance

Microfinance consists primarily of providing financial services including, savings, micro-credit, micro insurance, micro leasing and transfers in relatively small transactions designed to be accessible to micro-enterprises and to low-income households. Microfinance may be complemented by non-financial services, especially training, to improve the ability of clients to utilize the facilities effectively.

2.2 Performing Loans

Legally, a credit facility is defined to mean a contractual promise between two parties where one party, the creditor agrees to provide a sum of money to a debtor, who in turn promises to return the said amount to the creditor either in one lump or in installments over a specified period of time. The agreement may include provision of additional payment of rental charges on the funds advanced to the borrower(debtor) for the time the funds are in the hands of the debtor. The additional payments that are in the form of interest charges, processing fees, commissions, monitoring fees, among others are usually paid in addition to the principal sum lent. Indeed, these additional payments if made in accordance with the covenants of the credit facility constitute the interest income to the lender/creditor. A loan /credit facility may therefore be considered as performing if payment of both the principal and interest charges are up to date as agreed between the lender and the borrower. Per the Bank of Ghana(BoG) classification, loans are considered current if the payment of principal and interest are up to date. It goes further to stipulate that an overdraft is classified as current or performing if there are regular activities(swing) in the account with no sign of hard core debt build-up.(BoG, 2008). It can therefore be deduced that loans that are up to date in terms of principal and interest payment are described as performing loans and they constitute the healthy asset portfolio.

2.3 Non Performing Loans(NPLs)

The term Non-Performing Loans is used interchangeably with Bad loans and impaired loans as identified in Fofack(2005). Berger and De young (1997) also describes these types of loans as“problem loans” In broad context, loans that are outstanding in both interest and principal for a period of time contrary to terms and conditions spelt out in the loan agreement are considered as non performing loans. Available literature gives varied descriptions of non performing loans. Some researchers observe that whilst certain countries use quantitative criteria, e.g the number of days the credit facility is overdue, others rely on qualitative criteria such as information about the customer’s financial status and management judgement about future payments.(Bloem and Gorter,2001)

Alton and Hazen(2001) described non performing loans as loans that are ninety days or more past due or no longer accruing interest. Caprio and Klingebiel(1990) cited in Fofack(2005), consider non performing loans as loans which for a relatively long period of time do not generate income, that is both the principal and interest on these loans remain unpaid for at least 90 days. A non performing loan may also refer to one that is not earning income and full payment of principal and interest is no longer anticipated, principal or interest is 90 days or more or the maturity date has passed and payment in full has not been made.(http://teachmefinance.com/FinanceTerms/nonperformingloan.html)

The above descriptions of non performing loans indicates that loans for which both principal and interest have remained unpaid for at least 90 days are considered non performing loans. Analysis of the loan portfolio of five selected Microfinance institutions namely Pro Credit, Sinapi Aba Trust, Opportunity International, First Allied S & L and La Community Bank in December 2010 showed that out of a total loan portfolio of GH¢108,214,000, GH¢6,125,000, representing 5.6% was classified as non performing. These were the loans falling into the adverse classification category. The problem of NPLs in MFIs is a widespread phenomenon in Africa and some East Asian countries such as India and Bangladesh. For instance, the National Bank of Rwanda reports that NPLs owed to Microfinance Institutions rose from 3.6 billion dollars in 2010 to 6.8billion in 2011. Quantitative criteria for identifying non performing loans will be used in this study. Thus, any loan whose repayment has been outstanding for at least 90 days is considered a non performing loan. According to Berger and De Young (1997), such loans could be injurious to the performance of the financial institutions.

2.4 Loan Classification and Provisioning

All licensed financial institutions are required to monitor and review their portfolio of credit and risk assets at least once every quarter on a regular basis. Assets are classified into four grades of risk: (i) standard; (ii) sub-standard;(iii) doubtful; and (iv) loss. Assets in risk grades (ii) to (iv) are considered non-performing and therefore no income may be accrued on them. BOG has specified prudential norms for microenterprise and small business finance which take into account the characteristics of the enterprises and businesses in these two categories. Microfinance and small business loans are required to be reviewed once every month and are to be classified into (i) current, or (ii) delinquent. A delinquent loan is one on which payment of interest or scheduled payment of principal has not been received as of due date. BOG does not permit interest income to be accrued on delinquent loan accounts.

2.4.1 Provisioning for portfolio at risk.

Across the world, the major factor considered by the lending institutions before granting loans is the ability and the willingness of the borrower to repay the loan on the due date. When the probability of collecting a loan becomes very low, the normal practice is to charge the loan off by deducting its value from the loan portfolio balance by reducing loan loss reserve or, if there is no reserve, by charging an equivalent expense to the income statement . Thus, as a results of uncertainties in future cashflows and willful defaulting and to be able to minimize the risk of default, microfinance institutions normally require security in the form of guarantee and/or deposit, (usually up to 25% of the loan amount). Borrowers who miss payments are pressured at the due date and if the arrears continue, legal action is initiated against the borrower and guarantor(s) to recover any amounts owed, but usually after the designated collateral has been seized and liquidated to reduce the borrowing(outstanding loan balance). Provisioning for delinquent microfinance and small business loans is made on a "basket" basis, rather than on an individual loan basis. Basket-based provisioning involves making a blanket provision for the aggregate outstanding balances of loans grouped in each age basket, without regard to any security available for individual loans.

The prescribed rate of provisioning for microfinance and small business loans is shown below:

In addition to the specific loss provisions to be made for delinquent or non-performing microfinance and small business loans, BOG requires licensed MFIs to maintain a general loss provision of 5% of the aggregate outstanding of all the current or standard class of loan assets. Microfinance institutions are also required to separately disclose, in their financial accounts and reports, the specific and general loss provisions made for non-performing or delinquent loans and standard/current loan assets.

Loans Classification and provisioning.

Table 2.1

	PROVISION	NO OF DAYS OF DELINQUENCY
1	5%	Up to 30 days
2	20%	31-59 days
3	40%	60-89 days
4	60%	90-119 days
5	80%	120-149 days
6	100%	150 days and above.

2.5 Implication of NPLs for Microfinance Institutions

The interest income generated from loans contribute significantly to the profitability performance of the microfinance institutions. However, when loans become delinquent, it has a serious negative effect on the health and operations of the MF institution. One of the reasons is that, in line with the Bank of Ghana regulations, the lending institution has to make provision and charges for credit losses(bad debt/impairment) which ultimately reduce the profit level.

Again, large non performing loan portfolio tend to undermine the Microfinance company's ability to grant more credit. This is because the loanable funds tend to deplete when repayment of loans delays or fail to come.

Another important implication of non performing loans; which is sometimes described as ‘toxic asset’ is the loss of confidence on the part of depositors and investors leading to liquidity challenges. Yet again, another implication of non performing for the microfinance institutions is the that huge amounts written off as bad debt adversely affect the growth of the shareholders wealth since the profit which is re-invested(ploughed back) into the business to grow the capital base is reduced as a result of provision for credit losses. In a similar token, dividend payment is equally negatively affected because the provision for credit losses are deducted before dividends are declared.

Some foreign literatures indicate that failing banks have huge amount of non performing loans prior to failure and that asset quality is a significant predictor of insolvency.(Berger and De Young(1997). Indeed in Ghana, most MFIs have collapsed mainly on the account of non performing loans. The issues discussed above show the gravity of the implication of non performing loans on the operations of MFIs and this study attempts to identify the major causes of these NPLs among other objectives and proffer some suggestions aimed at reducing the incidence of NPLs in MFIs in Ghana.

2.6 Factors Accounting for NPLs

Some research findings and publications indicate that non performing loans are caused by poor management. Berger and De Young (1997) .They argue that managers in most banks or MFIs with the problem of non performing loans do not practice adequate loan underwriting, monitoring and control.

Credit culture is another factor which has been identified by some research findings(*e how*) as a cause of NPLs. Sometimes borrowers decide to apply for loan without thinking enough about the future and what else they need to buy with their income. When this occurs, a credit culture can develop where borrowers take out large loans not because it is financially wise to do so but because they see others do it. This can result in defaulted loans.

A world Bank policy research working paper on NPLs in Sub-Saharan Africa revealed that NPLs are caused by adverse economic shocks coupled with high cost of capital and low interest margins (Fofack, 2005) Goldstein and Turner (1996) stated " the accumulation of NPLs is generally attributable to a number of factors, including economic downturn, macroeconomic volatility, terms of trade deterioration, high interest rate, excessive reliance on overly high-priced inter-bank borrowings, insider borrowing and moral hazard.

Another literature(e how) identified sudden market changes as yet another factor which account for NPLs. Any sudden market change can change the loan market by affecting how much money people can take as loans and make payments. If the market suddenly changes and prices of items increase due to shortage or increased demand, borrowers will have less money to pay off their loans which can lead to loan default.

Nicholas Rouse (1989) indicated in his work that problem loan can emanate from overdrawn account where there is no overdraft limit or overdraft taken on account which has not been actively operated for some time and overdraft taken in excess of the reasonable operational limit. He also identified lack of good skills and judgement on the part of lenders as a possible cause of NPLs.

Bloem and Gorter(2001) asserted that NPLs may be caused by less predictable incidents such as the cost of petroleum products, prices of key exports, foreign exchange rates, or interest rate change abruptly. They also indicated that poor management, poor supervision, overoptimistic assessments of creditworthiness during economic booms and moral hazards resulting from generous government guarantees could also lead to loan default.

Again, another publication(kalyan-city.blogspot.com) identifies speculation : i.e investing in high risk assets to earn high income and also fraudulent practices such advancing loans to ineligible persons or advances without security or reference as some of the causes of NPLs. It also cites internal reasons such as labour agitation/shortage and market failure as some of the causes of the incidence of NPLs. External factors such as recession in the economy and natural calamities/disasters were also cited by the same publication as some of the factors accounting for loan default.

2.7 Loan Processing in MFIs

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

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

Individuals and micro-entrepreneurs that apply for loans from Sinapi Aba Trust proceed through three stages prior to obtaining approval.

(i) Preliminary Screening

In this stage, loan applicants make contact with the institution and are carefully screened and asked to answer specific questions regarding the status of their business and household accounts, in order to establish whether they qualify under SAT's eligibility guidelines. This is one of the most critical stages in the loan processing procedures since it is the stage where the information about the business and creditworthiness of the customer is analysed.

(ii) Loan Proposal and Credit Committee

Loan applicants are assigned to specific loan officers. Applicants undergo a further review to verify the information taken at the initial stage, and a visit to the applicant's businesses and household is arranged. The information thus developed is organized into a formal loan proposal and presented to the credit committee for approval. The loan amount and tenure are determined based on the adequacy of the cash flows generated by the borrower's business, sufficient personal collateral and or guarantors agreeing to co-sign the loan agreement.

(iii) .Monitoring and Repayment

After disbursement, the account officer frequently visits the borrower's business to ensure that the credit facility(loan) are being used for the specific purpose(s) for which the loan was granted, and to remind borrowers of their next repayment date. According to Rouse(1989) this is one area many lenders pay little attention but if it is properly followed, the incidence of NPLs can be reduced considerably. He identified internal records, visits and interviews, audited and management accounts as some of the things that help in the monitoring and control process.

Monitoring can help minimize the incidence of NPLs in the following ways:

- Ensuring the utilization of the loan for the intended purpose
- Identifying early warning signals of any problem relating to the operations of the business that are likely to affect the performance of the loan
- Ensuring compliance with the covenants of the loan facility.
- Affording the lender the opportunity to discuss the problems and prospects of the borrower’s business.

Borrowers who miss repayments are pressured at this stage; if the arrears continue to pile up, legal action is initiated against the borrower and guarantor(s) to recover any amounts owed, but usually after the designated collateral has been seized and offset against the indebtedness.

2.8 Reducing Non-Performing Loans in Microfinance Institutions

The incidence of NPLs can be reduced by ensuring that loans are granted to only applicants who demonstrate the ability to repay the loan at the agreed date. Credit analysis of the prospective borrower should be carried out to determine their risk profile and to reach a sound credit decision.

Again, loan repayment should be constantly monitored and whenever there is a default in repayment a quick action should be taken. The MFIs should also avoid granting loans to the risky customers or for speculative ventures, monitor loan repayments, and renegotiate loans whenever borrowers get into difficulties.(Kay Associates Ltd, 2005)

Golden and Walker (1993) also identify the 5Cs of bad credit, which represent things to guard against to help prevent the incidence of NPLs.

1. **Complacency** refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are over reliance on guarantors, reported net worth or past loan repayments success because things have always worked out well in the past.
2. **Carelessness** involves poor underwriting typically evidenced by inadequate loan documentation, lack of current financial information or other pertinent information in the credit files and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problems before they become unmanageable.

3. **Communication** ineffectiveness refers to when a Lender's credit objectives and policies are not clearly communicated. This is when loan problems can arise. Management must effectively communicate and enforce loan policies and loan officers should make management aware of specific problems with existing loans as soon as they appear.
4. **Contingencies** refer to lenders' tendency to play down or ignore circumstances in which a loan might result in default. The focus is on trying to make a deal work rather than identifying downside risk.
5. **Competition** involves following competitor's behaviour rather than maintaining the lender's own credit standards. Doing something because another lender is doing it does not mean it is a prudent business practice.

2.9 Challenges facing the Microfinance Sector

The key challenges confronting the microfinance institutions in developing countries such as Ghana include Inadequate funding for capacity building, inadequate and expensive infrastructure base, Inadequate credit delivery and management, the inability to target the vulnerable and the marginalized, information gathering and dissemination, regulation and supervision, consumer protection and research, monitoring and evaluation.

(i) Capacity Building

The growing competition, poaching of staff and lack of training and increasing demand for higher pay levels make human resources one of the most intractable problems in the sector. Capacity building in the form of a skilled and professional human capital base and adequate access to funding is essential for the building of a sustainable and efficient microfinance sector.

(ii) Inadequate and expensive Infrastructure base

Inadequate and expensive infrastructure such as communication, information technology, roads and electricity results in high operational cost within the microfinance sector. The current limited supply of these resources limit operations and drives up cost. In respect of infrastructure development, there is the need to establish a solid base and provide adequate logistics such as telecommunications and information technology to support the operations of microfinance institutions to make them more efficient.

(iii) Inadequate Credit delivery and management

The mechanism for credit delivery within the microfinance sector is inadequate and the microfinance institutions do not have the expertise to categorize their client into the various poverty categories so as to meet their specific needs.

(iv) Information Gathering and Dissemination

Lack of adequate and reliable information remains a challenge to the microfinance industry. These problems adversely affect the ability to properly target the right clients in order to meet the specific needs of such clients. There is also a paucity of information on microfinance institutions and their operations.

(v) Regulation and Supervision

Microfinance institutions in the formal sector operates within a rigid regulatory and supervisory environment which presents some challenges for innovation, outreach and overall performance of the institutions. There is also an absence of specific BoG regulatory guidelines for the apex bodies in the semi-formal and informal sectors for the supervision of their members.

The next chapter will deal with methodology and procedures involved in the research work and underlying basis for selecting such methods in conducting the research and it also provides a contextual profile of the operational activities of SAT.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter presents two broad issues. Firstly the methodology adopted and used for the study has been discussed. These include the research design, sampling, data collection and analysis techniques among others. The second issue discussed is the profile of SAT focusing on brief history and scope of activities.

3.1 Research Design

In conducting research, there are many strategies that can be used. The research strategy could be experiment, survey, case study, grounded theory and archival research. (Saunders et al, 2007). No research strategy is inherently superior or inferior to any other. What is most important is that a particular research strategy will enable the researcher to answer a particular research question(s) and realize the objectives (Saunders et al, 2007). The research will employ the use of a case study because it represents a comprehensive description and explanation of the many components of a given social situation. Robson (2002:178) as cited by Saunders et al, 2007; defines case study as ‘a study for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence’.

Further, the study being an explanatory one necessitates personal contact, so the questionnaires were administered and face-to-face interviews were conducted by the researcher to obtain the information which could not be revealed by the questionnaire.

The case study design was employed to find answer to the research questions. The Justification for this method is that it generated answers to the questions such as why, what and how, which helped in answering the research questions. A case study strategy is mostly used in exploratory and explanatory research (Saunder et al, 2007)

3.2 Population and Sampling

SAT has forty-six(46) branches across the country to cater for the microfinance needs of its numerous customers across the country. Thirty-four loan(credit) officers and sixteen(16) branch managers were selected from the entire population of the credit officers and branch managers of the institution. This forms about 36% of the total population of credit officers and branch managers of SAT. These were people who had varied experience in microcredit administration.

Biases were avoided in the selection of participants by drawing respondents from different branch locations, Area offices and the Head office of the institution. In all, thirty-five branches were covered, representing about 80 % of all the branches. At the branch level, credit officers with at least two years experience were purposively considered suitable for interviewing for data collection. At the Head office, Recovery managers and credit risk managers were also interviewed. This ensured that relevant information relating to the topic was obtained for the study. These methods made access to the needed data to achieve the objective of the research less difficult.

3.3 Sources of Data

Primary and secondary data constituted the sources of information for the research. The administration of questionnaires forms the basis of primary data. Data collected from this source focused on the background characteristics of respondents and their knowledge on the operational activities of Microfinance; particularly microcredit, challenges affecting the operations of microfinance and the impact of NPLs on the operations of MFIs.

In the case of secondary sources, information from published and unpublished sources including official annual financial reports of Sinapi Aba Trust were used to support the primary data.

3.4 Methods of Data Collection

The data collected for the study consisted of primary and secondary data. The type of data, their sources and the instruments used in gathering them are discussed as follows:

3.4.1 Primary Data

Both structured questionnaires and interview guides were used in the data collection. While the structured questionnaires were used to get the unbiased opinion of respondents, the interviews were used for clarifications of some unclear issues such as factors that account for high NPLs in certain sectors of the economy, how poor credit appraisal result in bad loans among others. Specimen of the questionnaire is attached as Appendix I. These data collection instruments made it very convenient for respondents to give the information needed for the analysis. Practically, it was not possible to be physically present to administer the questionnaires to all respondents and conduct the interview, so some of the respondents were contacted by telephone and briefed about the study. After they have agreed to participate, the questionnaires were mailed to them for their responses and thereafter mailed back to the researcher. The researcher was able to physically travel to three of the branch offices namely Mankessim, Dzorwulu and Sefwi Wiawso branches to conduct the interviews. Here, respondents were allowed to schedule the interview time and dates convenient for them. Information on the issues to be covered was given to the respondents to enable them prepare since some of the questions required facts and figures and also a little mental effort. The major questions were the research questions combined with some follow-up and probing questions where necessary. The flexible nature of these data collection instruments afforded the researcher the opportunity to probe some of the responses obtained. Interviewees and respondents were also given the chance to build on their responses or give further explanation when the need arose in the data collection process.

3.4.2 Secondary Data

The secondary date were obtained from the published annual reports and financial statements of the institution. The information covered a period of five years from years 2006 to 2010. This category of data was mainly found in the print and electronic media meant for public consumption. The use of this type of information was so beneficial in several ways to the study and some of the benefits include:

Firstly, this was less expensive to collect, in terms of time and money. It afforded the researcher the opportunity to collect high quality data which would not have been of the same quality if the researcher were to collect it in its primary form. Saunders et al (2007) quote Stewart and Kamins (1993) as stating that secondary data are likely to be of higher-quality than could be obtained by collecting empirical data. The data collected had in it very useful information needed to answer the research questions like loan portfolio of the institution, provision and charge for credit loss(i.e provision for bad and doubtful debt) and profitability during the five-year period.

3.5 Pre-testing

A pre-testing activity of the data collection instruments was carried out to test the adequacy of the questionnaire in eliciting the needed response. Issues focused on were the construction of the English language, validity and reliability of the questions. It was undertaken in two of the branches which were eventually not part of the actual data collection exercise. There were a couple of ambiguities relating to the construction of the questions which were subsequently modified to remove any ambiguities regarding the intensions of the researcher. The respondents were asked about their opinions on the nature of the questions but no suggestions were made concerning the revision of the questions. The pilot study was very helpful to the researcher because it gave the researcher the confidence that the questions were going to elicit the needed response required for the study . It also gave an indication to the researcher that there were going to be follow -up questions aimed at clarifying some answers. This made the researcher anticipate and prepare for the possible questions which made the interview very successful.

3.6 Limitation of data collection

Largely, the data collection was a very successful undertaking. However, it must be said that some of the respondents had extremely tight work schedules coupled with individual personal commitments and this occasionally gave rise to delayed or rushed responses. Again, on a couple of occasions, agreed interview date and time had to be re-scheduled to enable a respondent attend to official assignment.

3.7 Data Analysis

The secondary data obtained were scrutinized to determine their suitability, reliability, adequacy and accuracy. The data was obtained for the period 2006-2010 and figures quoted in old currency were converted to the new currency by dividing by 10,000 and rounded to 2 decimal places to ensure consistency. Spread sheet and simple excel were used to process the data for the analysis. Tables and statistical diagrams like histograms, pie charts and line graphs also aided in the data presentation. The primary data were presented by some of these statistical tools and by way of narration. Presentation of the data on these statistical tools made the analysis very easy to understand. The statistical tools were used to convey the meaning of the data gathered and as such made the analysis straight forward.

3.8 Ethical Issues

Almost all the financial institutions have strict policy on confidentiality and one can pay the ultimate price for the breach of this duty of confidentiality. Divulging of information by employees to a third party can expose the institution to potential legal tussle and therefore being mindful of this ethical issue, the respondents were sometimes apprehensive in the disclosure of information. This genuine apprehension was addressed by first explaining the essence of the study to the respondents and also with the assurance that the data will be handled professionally and that their identities are not going to be revealed. The confidentiality of the information collected from interviewees was preserved by ensuring that their names and other information that could bring out their identities were not disclosed in the data collected. They were also made to understand their role in the data collection activity to find answers to the research questions. To avoid imposing the interviews on respondents, they were given the choice to opt out if the interview would affect them in any way or if for some reasons they were not comfortable in participating in the study.

The methods and procedures explained above were used in seeking the needed data for the analysis which are captured in the next chapter.

3.9 Organizational Profile of Sinapi Aba Trust

Sinapi Aba Trust (SAT) is an autonomous private and Financial Non Governmental Organisation(FNGO) established and duly registered in May 30th 1994 under the company's code 1963 (Act 179) as a company limited by guarantee to support the economically active poor to enhance their lives through microfinance and basic business training.

- **Our Vision**

We seek to become an institution dedicated to the building of a nation under the Almighty God where the strong help the weak and all people have the dignity of providing for themselves, their families, their church and their community"

- **Our Mission**

Our mission is to serve as a Mustard Seed through which opportunities for enterprise development and income generation are given to the economically disadvantaged to transform their lives.

3.9.1 Brief History of Sinapi Aba Trust

Sinapi Aba Trust (SAT) also referred to as "Sinapi" is a Christian Not-For-Profit Organization established in 1994 as one of the implementing partners of the Opportunity International network (OI) – an International Christian Non-governmental Organization with headquarters in Chicago, US. The company was formed to primarily provide small and micro-credit services to viable small and micro enterprises that could not access financial assistance from the formal banking institutions due to obvious reasons such as lack of adequate collateral. The name Sinapi Aba, which is the local name of the biblical mustard seed (Matt.13: 1-32) was adopted because it depicts the magnitude and potential of the assistance that the organization provides to its clients. Leading members of Christian Life Center (CLC) brought in the idea for the formation of the Trust as part of the Church's mission in Ghana. However, the formation of a similar organization had already been conceived in the minds of some Christian and Business Leaders who later became Board Members. Upon several meetings and discussions, the company was finally birthed at a meeting held between Messes Larry Reed (OI), Jonathan Wilson and Rev. Davis Freeman (Board Chairman of SAT) in 1994. The background of Sinapi also relates to the fact that, Ghana possesses one of the vibrant informal sectors in Africa. In Ghana and most especially in the urban centres, almost every home has a small business attached to it. This depicts the existence of entrepreneurial spirit among the people but lack of financial assistance has crippled most of these enterprises whose contributions to the growth and development of Ghana cannot be overlooked.

3.9.2 Activities and Products

Sinapi targets the small and micro entrepreneurs serving them with various products: Trust Bank Product Trust bank is a convenient, simple and reliable loan product that gives access to working capital funds and financial support to the low income entrepreneurs. The Trust Bank (TB) is a development-intensive group lending product designed to cater for the micro-entrepreneurs. These are small loans offered to smallest businesses, typically owned by low income women, with household incomes well below the poverty line. Clients are organized into groups in order to access the service.

- **Solidarity Product**

  The product is easy, flexible, convenient and reliable loan product for successful matured Trust

  Bank clients and smaller business entrepreneurs to help them grow and sustain their business. Again, clients are organized into groups in order to access the service.

  Enhanced Solidarity

  Enhanced Solidarity product is a bendy, easy access, convenient and reliable business development loan. It is targeted at small entrepreneurs who have grown their businesses to an appreciable level and needs capital injection to stimulate growth.

Individual Loan Product

Individual Loan Product is a flexible, simple and reliable working capital loan for individual small and micro entrepreneurs who are capable of obtaining loan individually. This product is to aid small and micro entrepreneurs grow their businesses steadily and progressively.

- **Small Enterprise Loan (SEL)**

SEL is a simple, flexible and convenient loan product for clients' that have grown and expanded their businesses over time and need quite bigger loans to further expand their businesses.

- **Sinapi Special Agricultural Loan**

Sinapi Special Agricultural Loan is simple and reliable tailor made loan product for farmers. This special agricultural loan facility is to help farmers gain easy access to loan in support of their farming activities.

- **Sinapi Asset Loan (Ejuma Nkoso)**

This is a simple, reliable and flexible loan product that gives clients' the opportunity to acquire a business asset to increase their business efficiency. The product is to create avenue for both clients and prospective clients to enjoy the advantages of economies of scale as they scale up their businesses.

Sinapi Education Loan (Nimdeɛ Ye)

An easy, simple and reliable loan product which gives clients' that peace of mind and stress free life in settling their children's school fees obligation and other educational cost.

- **Micro school Loan**

This is a special product that supports micro and less developed schools to increase both outreach and quality of education delivery.

- **Financial Services**

Sinapi Aba Trust provides the following financial services:

- **Loans**

This involves the provision of loans to clients based on an assessment of clients' business

operations. There are limits to the amount of loan that a client can obtain at first and in subsequent loan cycles, but in most cases, the nature and size of clients' business, rate of turnovers and experience determine the amount of loan that one can obtain at any time.

- **Non-Financial Services**

SAT offers the following non-financial services:

- Business Management Training - Building client's business management capacity.
- Youth Apprenticeship Program (YAP) - Providing poor and vulnerable youth with employable skills.
- HIV/AIDS - Awareness creation and Counselling services for clients.
- Consultancy Services - Providing clear and cogent solutions tailored to the needs of other microfinance institutions.

CHAPTER FOUR:

DATA ANALYSIS, DISCUSSION AND PRESENTATION OF RESULTS

4.0 Introduction

The chapter captures the presentation, analysis and discussions of the data used in this research work. The objective of the study is to determine the causes of NPLs and its impact on the operations of MFIs in Ghana with SAT as the case study. This chapter thus depicts the findings which seek to answer the research questions against the background of the objectives of the study. The causes of NPLs, the impact of NPLs on interest income, operating profit, liquidity and loanable funds are analysed and discussed in this chapter. The chapter also touches on the default rate sector-wise. Generally, the chapter plays a very key role in the entire research work since it relates empirical data to secondary data reviewed in the previous chapters.

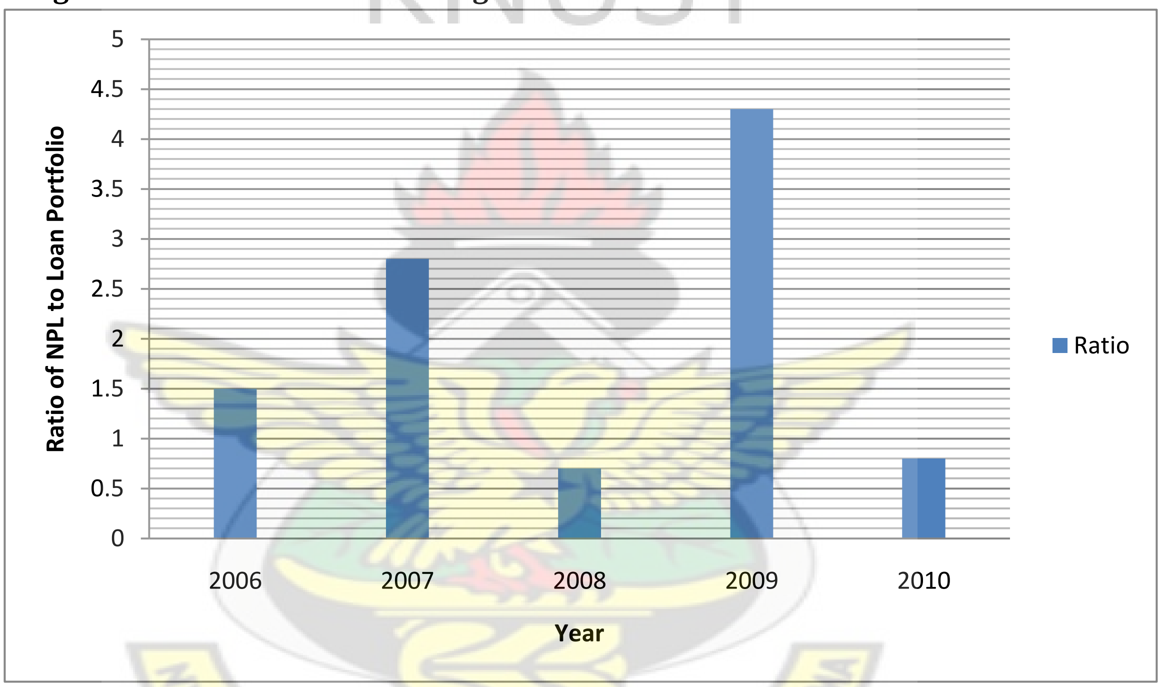
4.1 Analysis of Trend of Non Performing Loan figures(2006-2010)

This analysis seeks to establish a pattern of the non performing loans in SAT in the period under consideration, i.e 2006-2010. Table 4.1 and figure 4.1 give a respective tabular and pictorial representation of the NPLs figures from 2006 to 2010.

Table 4.1-Trend of NPLs

Item/Year	2006	2007	2008	2009	2010
Loan	**6,635,501**	**13,583,601**	**16,726,745**	**22,080,270**	**29,410,105**
Impairment	98,056	377,532	122,815	948,181	242,082
Ratio of Impairment to total Loan portfolio	1.5%	2.8%	0.7%	4.3%	0.8%

Fig. 4.1 -Trend of Non Peforming Loans



Source: Annual and Financial Statement, 2006-2010

From the table above, the provision for credit losses expressed as a percentage of total loan portfolio were 1.5%, 2.8%, 0.7% 4.3% and 0.8% for 2006, 2007, 2008 2009 and 2010 respectively. These ratios are worrying because according to the data captured in Microbanking Bulletin reported by the Ghanaian journal(2010), the proportion of loan portfolio in default for more than one year for global peers group is 1.5%. whilst that of

Ghana was 3.5%. It is seen from the table that the ratio of NPLs increased from 1.5% in 2006 to 2.8% in 2007. The ratio however declined significantly from the previous figure of 2.8% in 2007 to just 0.7% in 2008. This massive decline in the ratio which also represents an improvement in the quality of loan portfolio is however attributable to renegotiated loans in 2008 and not the recovery of delinquent loans per se according to one of the respondents. All renegotiated loans are treated as new loans and therefore treated as current or standard credit facilities. In 2009 , the ratio rose sharply from 0.7% in 2008 to 4.3%. This sharp rise is not surprising, looking at the high risk profile of renegotiated loans. This means most of the renegotiated loans slipped into adverse classification in the following year. It is instructive to observe that in absolute terms, the non performing loan figure for 2009 is larger than the figures of all the remaining years put together. The main reason for this huge figure is that if renegotiated loans are not tracked specially and separately, an indication of the borrower's repayment problem(difficulty) will disappear and he/she is likely to renege on their repayment proposal again.

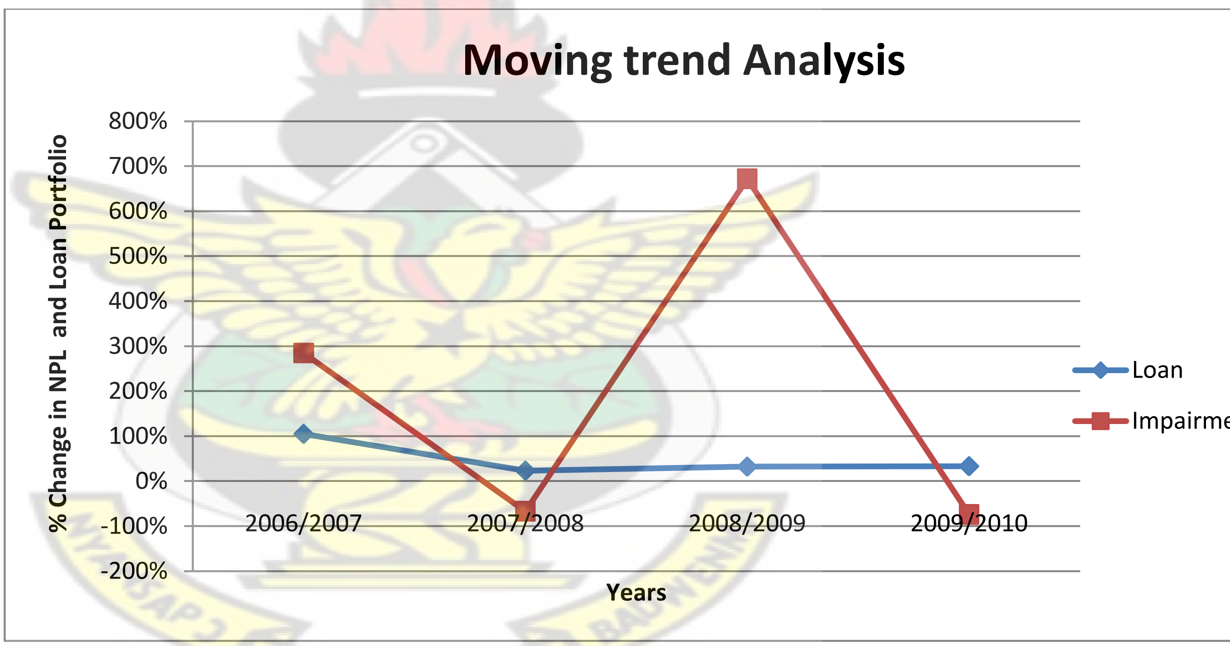
In 2010, there was a marked improvement in the quality of the loan portfolio as only 0.8% of the total loan was classified as non performing. According to one respondent, management was getting worried about the growing trend of the ratio of NPLs to loan portfolio and instituted measures aimed at halting the trend and that resulted in the significant reduction in the growth of the ratio of NPLs in 2010. It is seen from table 4.1 that from 2006 to 2007, the company expanded its loan portfolio by over 100% and this was done without corresponding expansion in logistics such as vehicles, motor bikes and hiring of additional field officers(credit officers) for effective monitoring. The resultant effect was that loan portfolio increased by more than 100% and provision for credit losses also increased by 285% in the same period.

4.2 Moving Trend Analysis of the NPLs

Table 4.2:Moving Trend Analysis of Loan Portfolio and Bad Debt

Item/year	2006	2007	2008	2009	2010	%Change 06-07	%Change 07-08	%Change 08-09	%Chg 09-10
Loan	6,635,501	13,583,601	16,726,745	22,080,270	29,410,105	105%	23%	32%	33%
Impairment	98,056	377,532	122,815	948,181	242,082	285%	-67%	672%	-74%
NPL ratio	1.5%	2.8%	0.7%	4.3%	0.8%				

Fig,4.2:Moving trend analysis of Loan Portfolio and Bad Debt



Source: Financial Statement(SAT) :2006-2010

From the table 4.2, it is seen that the NPLs increased by 285% from 2006 to 2007. This trend, if had been allowed to continue could have impacted negatively on the operations of SAT. The percentage change (increase) of 105% from 2006 to 2007 in the loan portfolio was significantly high and that must have partly accounted for the huge provision made for impairment in year 2007. In 2008, it is realized from the table that aside the fact that loanable funds for year 2008 was reduced by the huge provision made for credit losses in year 2007, management is said to have made conscious effort to slow down on granting of loans and rather focused attention and direct energy towards the recovery of the existing due and overdue loans and advances. This effort yielded some dividends in 2008. As can be seen from table 4.2, the impairment figure actually decreased by 67% between 2007 and 2008. This is considered a marked improvement in terms of the quality of the loan portfolio. Between 2008 and 2009, the provision for impairment rose astronomically by 672% and this was really worrying because the total loan portfolio itself increased by just 32% from 2008 to 2009. The deteriorating trend of the portfolio improved significantly from 2009 to 2010 that saw a decrease of 74% in the impairment figure. All in all, the general trend has been erratic even though huge amounts of money has been provisioned as non performing loans and with recent figure being a decline of 74% from the previous year's figure.

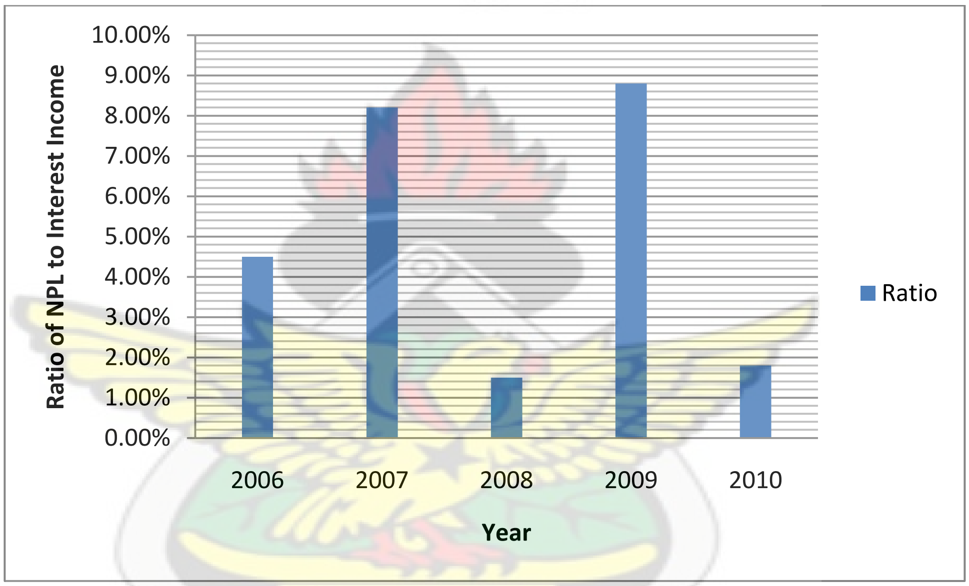
4.3 Impact of NPLs on Interest Income

Without doubt, interest income is the leading source of income to all lending institutions including SAT. This analysis seeks to determine the effect of NPLs on the interest incomes.

Table 4.3 NPLs to Interest Income

Item/Year	2006	2007	2008	2009	2010	TOTAL
Interest Inc	2,172,942	4,621,748	8,279,403	10,828,324	13,288,951	39,191,368
Impairment(NPL)	98,056	377,532	122,815	948,181	242,082	1,788,666
Ratio of NPL to Int. income	4.5%	8.2%	1.5%	8.8%	1.8%	4.6%

Fig 4.3: NPLs to Interest Income



Source: SAT Annual and Financial Statement, 2006-2010

Table 4.3 reveals that there was a consistent increase in the interest income generated from the loan portfolio from 2006 to 2010. These incomes were however reduced by the provision for credit losses. The provisions were 4.5%, 8.2%, 1.5%, 8.8%, and 1.8% for 2006, 2007, 2008, 2009, 2010 respectively. It is further seen from the table that year 2007 and 2009 recorded quite a substantial amounts in terms of provisions for bad debt and therefore saw a 8.2% and 8.8% of their respective interest incomes being eaten away by the charge for bad debt. The table further revealed that the provision for credit losses reduced the overall interest income for the five-year period by 1,788,666, representing 4.6%. The huge provisions made in 2007 and 2009 is mainly attributed to over 100% increase in loan portfolio without a corresponding increase in field officers which undermined effective monitoring and recovery in 2007 and also lack of monitoring of renegotiated and refinanced loans in (2008) which slipped into adverse classification in 2009. The ratio of NPL to the interest income was 4.5% in year 2006, this further rose to 8.2% in 2007. It however dropped significantly to 1.5% in 2008 mainly due to renegotiation and refinancing of the adversely classified loans. Of course, management also on realizing that delinquent loans are like a hidden beast which can easily spin out of control, embarked on a massive recovery program and this also helped in improving the quality of the loan portfolio in 2008. The ratio of NPLs to the interest income reduced heavily from 2009 to 2010. The period registered only 1.8% as a percentage of NPLs to the interest income, which is the second lowest in five years. This is an indication of the effectiveness of the recovery measures put in place by management to improve net income by reducing the provision for loan impairment. From the discussions above, it is seen that the huge reduction in interest income as a results of provision for credit losses negatively affected the total income of the company during the period under consideration. In conclusion, it can be said that the SAT saw its NPLs situation worsening from 2006 to 2007. Even though there was a significant improvement in 2008, the worsening trend recurred in 2009 but again SAT was able reduce the rate of loan default in 2010 largely due to intensive loan recovery activities. This improvement notwithstanding, the overall effect of NPLs on the interest income was negative since it eventually caused a reduction in the total income of the institution in the period being reviewed.

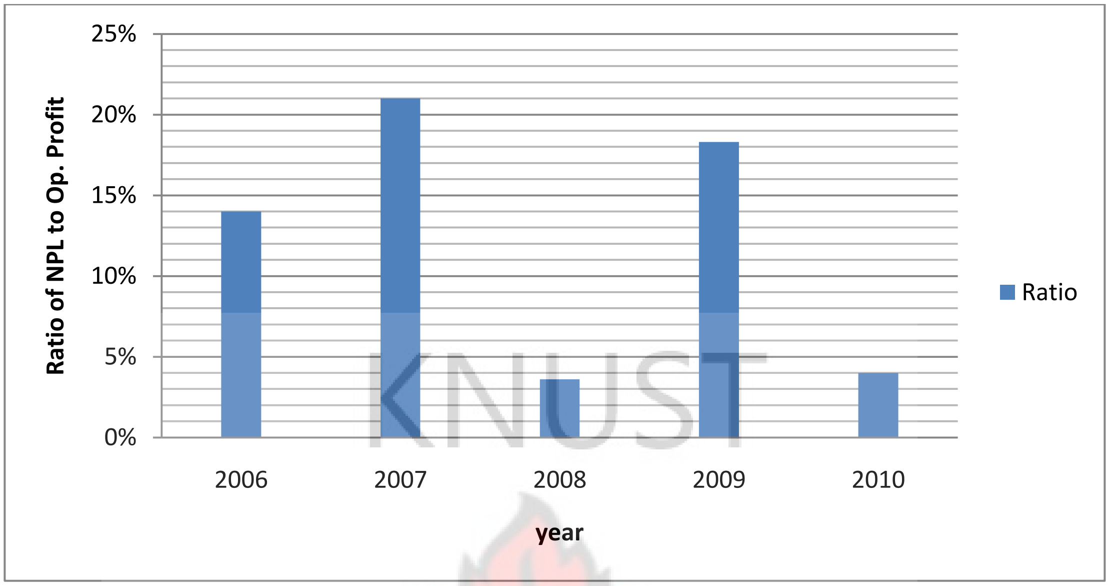
4.4 Impact of NPLs on Operating Profit

This analysis is done to establish the impact of NPLs on the operating profits of SAT for the period 2006-2010. The table below helps to give the tabular representation of this impact or effect for the five-year period (2006-2010)

Table 4.4: Impact of NPLs on Operating Profit

Item/Year	2006	2007	2008	2009	2010	Total
Operating Profit	701,624	1,786,883	3,399,972	5,188,672	6,076,313	17,153,464
Provision for credit loss	98,056	377,532	122,815	948,181	242,082	1,788,666
Ratio of provision to Operating profit	14%	21%	3.6%	18.3%	4.0%	10.4%

Fig. 4.4: Impact of NPL on Operating Profit



Source: SAT Annual Report and Financial Statement, 2006-2010

From table 4.4, it is seen that a respectable proportion of the operating profit has been eaten away by the provision for loan impairment as follows;14% of the 2006 operating profit was eroded by loan impairment. In 2007, the provision made for credit losses represent 21% of the total operating profit whilst 3.6% of the operating profit for year 2008 was lost as a result of provision for credit losses. In 2009, GH¢948,181 representing 18.3.0% of the operating profit got eroded due to provision for bad debt. The biggest impact of NPLs on operating profit was recorded in 2007 where the operating profit was reduced by GH¢377,532 representing 21% of the total operating profit whilst the lowest impact was registered in year 2008 where 3.6% of the operating profit was lost to loan impairment. In the five-year period, three years i.e 2006, 2007 and 2009 recorded an average ratio of about 18%.This means on the average about 18% of the total operating profit is provisioned for bad debt. In absolute terms, a total of 17,153,464 was recorded as operating profit in the five-year period but was reduced by 1,788,666, representing 10.4% due to bad debt. This situation can send a wrong signal to any potential investors and also upset the existing ones who wish to see their wealth growing rather than losing it to growing non performing loans. This obviously has a negative impact on the financial performance of the institution. The situation can also undermine the ability of SAT to raise additional capital from investors who are mostly concerned about the health of the loan portfolio of the financial institution they are investing their monies in. The year 2008 and 2010 saw a marked improvement in loan quality as only 3.6% and 4% of their respective operating profits were lost due to loan impairment. A combination of factors accounted for this remarkable performance and they include loan renegotiation, loan refinancing and effective monitoring and recovery programs instituted by the institution to address the problem of NPLs which reached a disturbing height of 21% of the operating profit in 2007. The import of this analysis is to highlight the impact of NPLs on the operating profit of the organisation and which ultimately affect the organization’s net profit negatively. It therefore behoves on the management of SAT to appreciate the havoc that NPLs can wreak on the fortunes of the organization and accordingly fashion out a comprehensive workable strategies to deal with it with the view to improving the quality of the loan portfolio and in the process increase the bottom line (net profit).

4.5: Impact of NPLs on Loanable Funds

The lending capacity of every microfinance institution is influenced by three parameters namely deposit, recoveries and disbursements. Lending capacity varies with Deposit mobilization, Recoveries and Disbursements(approvals). Therefore if the MFIs grant loans/advances and they are unable to collect back the principal amount and the related interest income, it reduces the funds available for lending and undermines its capacity to create new loans.

Table 4.5 depicts the impact of NPLs on funds available for lending.

Table 4.5 : Impact of NPLs on Loanable Funds

Year	PROV. FOR NPLs	POTENTIALLY PART LOANABLE FUNDS	INTEREST INCOME LOST DUE TO NPLs(RATE:37%PA)	TOTAL POTENTIAL AMOUNT LOST
2006	98,056	-	-	-
2007	377,532	98,056	36,281	134,337
2008	122,815	377,532	139,687	517,219
2009	948,181	122,815	45,442	168,257
2010	242,082	948,082	350,790	1,298,872
2011		242,082	89,570	331,652
Total	1,788,666	1,788,666	661,770	2,450,436

Table 4.5 indicates that an amount of GH¢98,056, GH ¢377,532, GH¢122,815, GH¢948,082 and GH¢GH¢242,082 would have been available for lending in 2007, 2008, 2009, 2010, and 2011 respectively but as a result of provision for credit losses, loanable funds were reduced by these figures. It also shows that the total interest income of GH ¢661,770 which should have been earned on those funds for the period

2007-2011 if the provision for bad debt had been used to create new loan at the rate of 37% pa (Average lending rate for the period 2006-2010). This obviously impacted negatively on the financial performance of the organization since the sum of the total lost interest income and the total lost loanable funds comes to GH¢2,450,436 in the five-year period. This amount is significant, considering the fact that the minimum paid-up capital requirement for tier 2 MFIs is now pegged at GH¢100,000 by the BoG. It is important to state again that the incidence of NPLs during the period under discussions seriously impacted negatively on the liquidity of the organization which could result in borrowing from other financial institutions at high cost. The incidence of NPLs can compel a financial institution to place a temporary freeze on or suspend entire lending activities.

4.6 Factor Accounting for the incidence of NPLs in MFIs

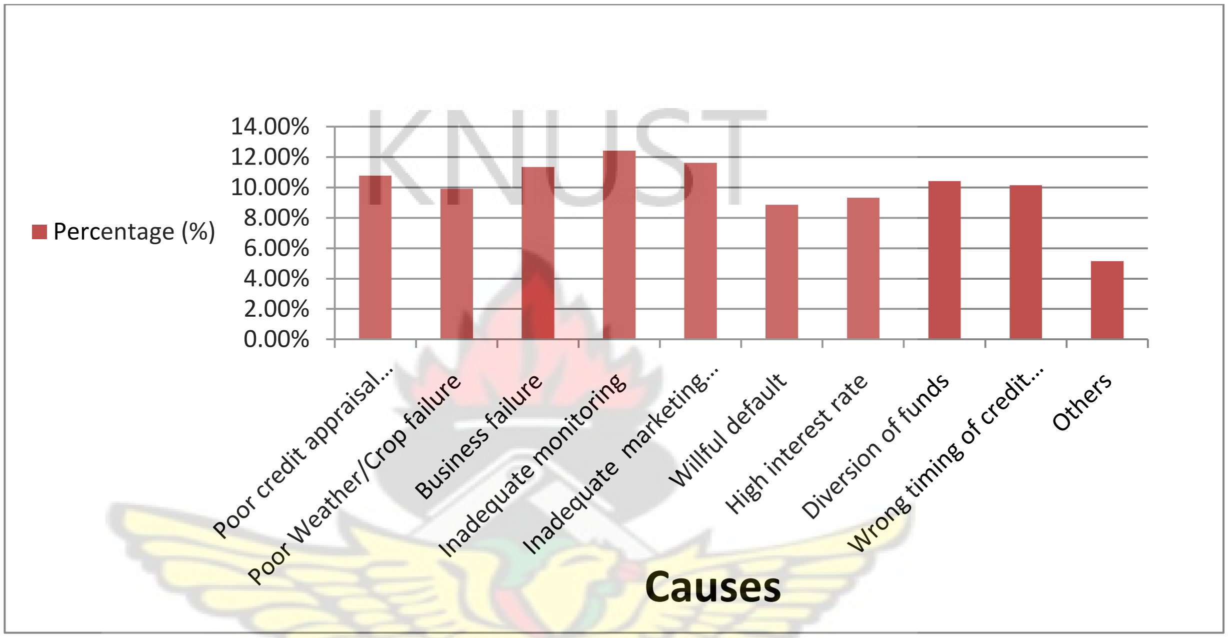
After the administration of the questionnaires and the conduct of the interview, the responses given by the respondents are discussed below. Many reasons were assigned to the causes of non performing loans in the MFIs. The major factors identified by the respondents were Poor credit appraisal techniques, Inadequate monitoring, Diversion of funds, Business Failure, Poor weather conditions, inadequate marketing avenues, Wrong timing of credit delivery, High interest rate, willful default among others. Respondent were asked to rank the causes of bad loans in MFIs using the scale of 1-10, with 10 being the most dominant cause, followed by 9 as the next most common factor and so on with 1 as the least dominant cause and the result are presented in table 4.5.

Table 4.6 Factors accounting for NPLs

Cause of NPL	Frequency of first position	Rank	Marks/Total Score	Percentage(%)
Poor credit appraisal techniques	28	4th	377	10.8%
Poor Weather/Crop failure	21	7th	347	9.9%
Business failure	30	3rd	397	11.3%
Inadequate monitoring	35	1st	435	12.4%
Inadequate marketing avenues	31	2nd	407	11.6%
Willful default	15	9th	310	8.9%
High interest rate	20	8th	326	9.3%
Diversion of funds	27	5th	365	10.4%
Wrong timing of credit delivery	23	6th	355	10.1%
Others	11	10th	180	5.3%

Source: Field Survey, May,2012

Fig. 4.5 :Factors Accounting for NPLs in MFIs



Source: Field survey, May, 2012

- **Ineffective Monitoring**

The respondents were to rank the causes of non-performing loans using a scale of 1-10 with 10 being the most important factor and 1 the least important factor. Out of 45 respondents who returned the questionnaires, 35 mentioned inadequate monitoring as the most dominant cause of NPLs. Understaffing and lack of logistics(vehicles/motor bikes) were the most common reasons cited as the causes of ineffective monitoring.

- **Inadequate Marketing Avenues.**

Inadequate marketing opportunities was cited by as many as 31 of the respondents as the second most dominant cause of NPLs in MFIs. Their reason was that as

a result of inadequate market, the wares get perished or produce suffer post harvest losses leading to inability to repay loans.

- **Business failure**

According to 30 of those who answered the questionnaires, business failure is the 3rd most important factor causing non performing loans in SAT. Those from whom the researcher sought further explanation said sometimes borrowers with previous satisfactory credit record suddenly default and most of such cases are traced to business failure.

- **Poor credit Appraisal techniques.**

In the view of 28 respondents, poor credit appraisal techniques on the part of credit/loan officers also account for some loans becoming delinquent. Such respondents rank poor credit appraisal techniques as the 4th most important causative factor of NPLs in SAT. They explain this to mean that some loan officers lack the skills to adequately assess a credit proposition to reasonably determine their commercial viability or otherwise. In this sense, they accept some unbankable projects which eventually fail and repayment of the loan becomes sticky.

- **Diversion of Funds**

The next factor that was cited by the respondents was diversion of funds. 27 of the respondents believe diversion of funds is indeed one of the causes of the incidence of

NPLs and they rank it number 5 on the scale of 1 to 10. Diversion of funds is where funds or loans granted to undertake a particular project is used for unintended purpose. This leads to a drop in the projected cashflows and ultimately result in loan default.

- **Wrong timing of credit delivery**

Sometimes, because of the delays in approving loans being requested by the customers, some business opportunities are lost before the loan amount is disbursed to the customers. When this happens and the disbursement is done in cash, because money has alternative uses, the borrowers tend to misuse these funds or at best use them for wrong or unplanned business ventures which in most cases fail to perform well. In the end they are unable to repay the loan. This reason was shared by 23 respondents and they place it at number 6 on the scale.

- **Poor weather conditions**

Poor weather was cited as the 7th most important factor causing non-performing loans in SAT. This belief was shared by 21 respondents. The respondents explained that often times, poor weather conditions include severe drought, excessive rainfall, late onset of rains and shortened rainfall period. One or combination of these factors could lead to crop failure. Once, a farmer experiences crop failure, naturally, loan default becomes imminent. This was an explanation offered by one credit officer in the Brong Ahafo region.

- **High Interest rate:**

High interest rate was cited by 20 respondents as a cause and it was ranked number 8 among the other reasons causing the incidence of NPLs in SAT. This was not considered too strong a reason because it is only applicable to loan defaulters who have managed to pay off outstanding principal and are in default in only interest payment. If a borrower is in default of both principal and interest, then one cannot assert that high interest rate is the actually the cause of the loan default.

- **willful Default**

These category of loan defaulters do so for no apparent reason. According to the respondents, many of the defaulters are considered to be in a position to repay the loan but somehow they fail to repay the loan. It is not considered to be a major cause of loan default in SAT and borrowers in that category are not too many.

- **Others**

Other factors such as difficulty in locating the houses of loan defaulters due to poor residential numbering system, under-financing, overtrading, bush fires, destruction of crops by cattle(Fulani herdsmen), high cost of inputs, inadequate storage facilities and information asymmetry were also cited as other factors accounting for the incidence of NPLs in SAT.

Lack of business management knowledge on the part of credit officers and non-compliance with the provisions of the credit policy were some of the other minor reasons cited as factors that result in loan default by the respondents.

4.7 Sectoral Analysis of NPLs

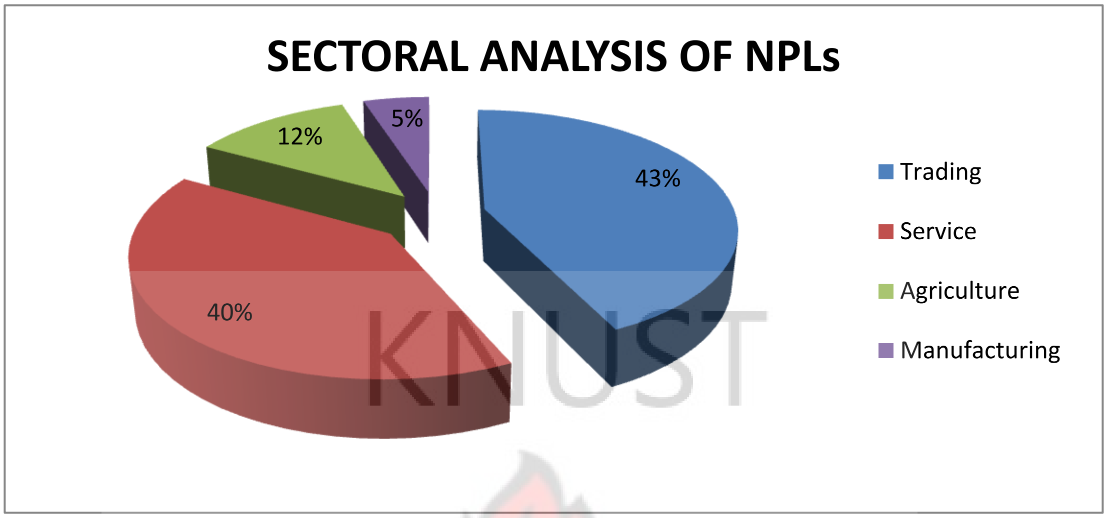
Respondent were asked to rank the sectors or sub sectors based on the incidence of NPLs in SAT using the scale of 1-10 with 10 being the sector with the highest incidence of NPLs and 1 as the sector with least incidence of NPLs and the results are presented in table 4.7

Table 4.7 Sectoral analysis of NPLs

	FREQUENCY OF FIRST POSITION	RANK	Percentages
TRADING	43	1ST	43%
SERVICE	40	2ND	40%
AGRICULTURE	12	3RD	12%
MANUFACTURING	5	4TH	5%

Source: Field Survey, May 2012

Fig. 4.6 Sectoral Analysis of NPLs



The lending activities of SAT are mainly concentrated on four sub-sectors of the economy namely trading, service, agriculture and manufacturing. The study found out that about 90% of the total loan portfolio is shared between trading and service.

It was established from the study that the incidence of NPLs is most prevalent in trading sector. The response in favour of trading being the sector with the highest incidence of NPLs was overwhelming. As many as 43 of the forty-five respondents representing 93% agreed that the largest percentage of the NPLs is to be found in the trading sector. The service sub sector was cited as the sub sector with second largest incidence of non performing loans in SAT. Forty(40) of the respondents indicated in their response that the sector with the second highest cases of NPLs is the service subsector. As mentioned earlier, these two sectors command a significantly large proportion of the entire loan portfolio. Naturally, because of the relatively low proportion of the loans in the agriculture and manufacturing, the two sectors do not contribute much to the total non performing loans in the SAT. The study established that agriculture sector is ranked third in terms of the sector with highest cases of NPLs. The subsector with the least proportion of NPLs was manufacturing.

Some of the respondents also indicated that sometimes undue pressures from customers can cause loan officers to disburse loans without the necessary legal documentation in place or can cause loans committee to approve loans for projects or businesses that are not worth financing in view of their inability to generate sufficient revenue for loan repayment. Besides, customers' pressure can result in unauthorized overdraft being given by branch managers in excess of the approved overdraft limit or without any approved limit as indicated by Rouse (1987). The risk associated with such unauthorized overdraft is that, if customers default in repayment, the organization finds it difficult to recover such facilities through legal means because it will find itself in a weak legal position.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This study was aimed at investigating the major causes of NPLs and its impact on the operations of MFIs with particular focus on Sinapi Aba Trust. This chapter summarizes the research findings and how both primary and secondary were obtained for the research work. It further gives the conclusion of the study and offers some recommendations in line with the objective of the study. The chapter is thus a conclusion of findings of the research, that is, a summary of the research outcomes and appropriate recommendations to help reduce the incidence of NPLs in MFIs.

5.1 Summary of Findings

It was established from the findings of the study that between 2006 and 2010, SAT recorded the highest NPL ratio in 2009 and this was followed by year 2007. The lowest NPL ratio of 0.7% occurred in year 2008. In general, the trend of NPL ratios was erratic during the five-year period under consideration. However, average NPL ratio of 2.02% for the period compared with the base year(2006) ratio of 1.5% clearly shows that on the average, the NPL ratio is on ascendency. The significant reduction in the NPL ratio recorded in 2008 is mainly attributed to renegotiation and refinancing of some adversely classified loans in 2008. The NPL ratio for 2010 was also relatively low and according to one senior management staff, the organisation is in the process of applying for a licence to operate as NBFI and that will require injection of additional capital so management has embarked on intensive recovery programme to recover most of the outstanding loan balances to improve its profitability and also engender investor confidence in the institution.

It is also seen from the moving trend analysis that NPL figures increased by 285% from 2006 to 2007. Even though the NPL figure declined by 67% between 2007 and 2008, the NPL position deteriorated again between 2008 and 2009; registering an astronomical increase of 672% between 2008 and 2009. The analysis further reveals that even though there was constant increase in interest income from loan since 2006, these interest incomes were eroded by the significantly high provisions made for loan impairment allowances. The total provision for credit losses for the period 2006 to 2010 was 1,788,666 which represent 4.6% of the total interest income generated within the five-year period. The impact of provision for loan impairment was particularly huge in year 2007 and 2009 with ratios of 8.2% and 8.8% of their respective interest incomes. Obviously, this high provisions for bad debt had a negative impact on the overall profitability performance of the institution. The situation is all the more worrying if one considers the fact that whilst the interest income rose from GH¢8,279,403 to GH¢10,823,324 representing 30.7% jump from 2008 to 2009 , the provision for bad debt increased from GH¢122,815 in 2008 to GH¢948,181 representing 672% jump in the same period. It is revealed from the analysis that a considerable proportion of the operating profit was eroded by provision for loan impairment allowance as follows: In 2006, 14% of the operating profit went into provision for bad debt. In 2007, the ratio went further up to 21% of the operating profit being provision for credit losses. In 2009 and 2010, 18.3% and 40% of the respective operating profits were provisioned as bad debt, after 3.6% of the operating profit has been lost to provision for credit losses in 2008. In total, an amount of GH¢1,788,666 was lost from the operating profit to provision for bad debt and this represent 10.4% of the total operating profit generated within the period 2006 to 2010. The average ratio of NPL to operating profit for the period under consideration was 10.4% and this indeed represents a considerable amount of the total operating profit.

The analysis further indicates that the provision for credit losses reduced the loanable funds by an amount of GH¢1,788,666 in the period under review. The findings also show that the institution again lost interest income of GH¢661,770.00 which would been earned(at 37% p.a for five years) as interest income on the lost loanable funds. This means that in total, the incidence of NPL reduced the loanable funds by GH¢2,450,436.00. This means the lending capacity of the organization is undermined and its investment opportunities are curtailed by the incidence of NPLs.

The findings of the study further revealed that a number of factors account for loan delinquency in organization. In the opinion of the respondents, the first most important factor accounting for the incidence of NPLs in SAT is ineffective/inadequate monitoring of loans. Inadequate marketing avenues, business failure, poor credit appraisal techniques were also roundly cited by the respondents as other major causes of the incidence of NPL portfolio in SAT.

It is also instructive to note that among the sectors or sub-sectors where the institutions concentrates its lending activities, trading recorded the highest incidence of NPLs. As high as 81% of the respondents agreed with this position. Indeed, it was established from the study that SAT focuses their lending activities mainly on Trading, Service, Manufacturing and Agriculture. The service sector is the next area with the highest incidence is NPLs. With trading and service sectors accounting for about 90% of the total portfolio of SAT, the concentration of the incidence of NPLs in these two sectors must be expected. This was an observation by one of the Branch managers. The agriculture and manufacturing sectors followed in that order in terms of sectoral incidence of NPLs in SAT.

5.2 Conclusion

From the summary of the findings of the study as provided above, some conclusion can be drawn from the analysis. It is obvious from the findings that within the period of the study ie 2006-2010, the institution recorded a sizeable proportion of NPLs in its total loan stock as shown in chapter four. The general trend of the incidence of NPLs in SAT was however erratic but averagely, it was on the increase. The improvement in the quality of the loan portfolio in 2010 resulting in only 0.8% of the total loan portfolio being classified as NPL is commendable and it gives an indication of management decision to convert from MFI to Non Bank Financial Institution and hence their determination to maintain a healthy loan portfolio to engender investor and depositor confidence.

In the light of the significant reduction of interest income, operating profit, and loanable funds occasioned by the incidence of NPLs, it can clearly be concluded that non performing loans adversely affected financial performance of SAT in terms of profitability, liquidity and market appeal within the period under consideration.

Among the factors that accounted for the incidence of NPLs, it was found out from the study conducted that ineffective monitoring of loans was the most important factor accounting for the incidence of NPLs whist trading was found to be the sub sector with the highest incidence of NPLs. It can therefore be concluded that the loans to the trading subsector which is major lending activity of the institution is most exposed to credit risk as compared to other sectors. It is therefore expected that management will adopt very effective risk mitigating measures in this subsector to improve the overall health status of the loan portfolio.

5.3 Recommendations

The findings of the research has brought to the fore the dire consequences that the incidence of NPLs in MFIs have on their operations in terms of profitability, ability to grant more credit, liquidity and investor and depositor confidence. The analysis clearly showed that NPLs have eaten a chunk of the organization's financial fortunes in the five-year period, i.e 2006-2010. In the light of the major role that MFIs play in extending financial support to micro-enterprises and low income earning bracket in the economy, it is important that sound and prudent measures are put in place to forestall the total collapse of the MFIs under the weight of the huge NPL portfolios in their books. Some of the measures recommended by the respondents and those gleaned from literature from different parts of the world are discussed below.

- Effective and Regular monitoring.

One of the most potent means of curbing the incidence of NPLs is by effective and regular monitoring of the loan from the time of disbursement till the final repayment. This will help to prevent diversion and misapplication of funds which are identified as two important causes of NPLs in MFIs. This activity also afford the loan officers the opportunity to inspect the books of accounting of the customers and help the customers to keep proper records of their business transactions. It is also recommended that management should make a conscious effort to resource the loan officers sufficiently at all times in terms of vehicle and other logistics to support the monitoring activities. It is also worthwhile to mention that management should ensure the periodic visit of the institution's internal auditing team to the branch to make sure that the branches comply with the stipulations of the credit policy. Effective monitoring of the loan facility and periodic review of the customer's accounts help the lending institution to pick early signals and take remedial measures to prevent further deterioration of the credit facility.

- Refresher Training Courses for Credit Officers and Managers

It is recommended that periodically relevant training programs are organized for loan officers particularly in the area of risk management, management of NPL and financial analysis. This helps improve the knowledge and analytical skills of the credit officers so as to improve their credit appraisal techniques. The training program will assist the loan/credit officers to appreciate the importance of prompt credit delivery in loan default prevention. Through the training, credit officers will be able to better assess and analyse the loan portfolios (using tools such as Portfolio at Risk {PAR} and ageing Analysis) and pick early warning signals much more quickly and take potent remedial measures to halt any further deterioration of the loan portfolio. It is also strongly recommended that management will always give a serious attention to the health of loan portfolio and resource the credit officers to prevent loans or credit facilities slipping into adverse classification. For effective training programmes, it is recommended that seasoned and knowledgeable bankers and micro finance experts with practical experience in microcredit be engaged to provide this training services. In all this, it is worth noting that commitment on the part of management to ensure successful implementation of training program is crucially important. In order to decrease the chance of NPLs, MFIs should be selective as to which borrowers or projects they accept for funding and available literature (Wikipedia) suggests that lending institutions which do poorly in this area risk creating more NPLs in their books.

- Provision of security for Credit Facility

In the light of the uncertainties that surround repayment of loans, lenders cannot tell from the looks of people's faces whether they are good or bad borrowers as indicated by Kwarteng(2007), it is therefore strongly recommended that MFIs will begin to demand some form of security even if not adequate to ensure that at least, it can recover part of the indebtedness in the event of default. This recommendation is even more critical at this time when the central bank (BoG) is taking steps to streamline and sanitize the operations of the MFIs in Ghana. Security such as blocked savings account, fixed deposit or guarantee could all be considered as acceptable security arrangements. This will reduce the losses arising from NPLs and help minimize the adverse impact of such loans on the financial performance of the MFIs. It is imperative to state that if a credit facility is secured in one way or the other, it reduces the chances of willful defaulting since the borrower is aware that the security will be realized to offset the indebtedness. Management is therefore strongly advised to review the security requirement policy with the view to tighten the screws to ensure that in the event of default, the institution will able to salvage something to compensate for the provision for credit losses or to reduce the impact of NPLs on its profitability.

- Use of Credit Reference Bureau

Most of the MFIs lack the efficient risk management mechanism that will help eradicate or sieve out serial defaulters. To effectively lock out these serial defaulters, MFIs requires referencing solution that will enable them submit and share data whilst processing their customers' credit application. The credit reference bureau is a body working in collaboration with the central bank to provide credit reference of prospective borrowers to lending institutions. The idea is to prevent borrowers with unsatisfactory credit record from accessing further credit from other unsuspecting lending institutions. The Credit Referencing Bureau collate the information of all borrowing customers into a common database where the credit history of any loan applicant can be cross-checked for a sound credit decision. It is therefore recommended to the management of SAT to avail itself of the services of this body to enable them to check the credit history of loan applicants. This will reduce the incidence of loans going bad since the organization will avoid lending to borrowers with unsatisfactory credit record.

- **Recovery Strategies**

The following recovery strategies are also highly recommended for adoption : **1.Personal persuasion**; in this strategy, the lender tries to appeal to the conscience of the defaulting customer to live up to their repayment obligation.

2.Civil procedure; here the lender institutes civil suit against the defaulting customer for the recovery of any outstanding debt after the persuasion avenue has failed.

3.Compromise(Negotiated settlement); in this strategy, when the defaulter demonstrates enough commitment towards retiring the indebtedness, the lender by way of encouraging the defaulter may waive part of the accumulated interest or defer interest payment. Prasad C.(2011)

REFERENCES

Adjei, K .J.(2010), Microfinance & Poverty Reduction: The Experience of Ghana.

Alton R.G and Hazen J.H (2001) 'As Economy Flounders, Do we see A Rise in Problem Loans? Federal Reserve Bank of St Louis.

Arunachalam , R.S.(2011), The journey of Indian Microfinance

Asiama J.P & Osei V.(2007), Microfinance in Ghana: An overview

Bloem, M. A and Gorter N.C (2001), Treatment of Non performing Loans in Macroeconomic statistics, IMF Working Paper, WP/01/209

Caprio, G Jr and Klinggebiel D(1996): Bank Insolvency-Bad Luck, Bad Policy or Bad Banking, Annual World Bank Conference on Development Economics.

Daniel Allotey(2008), Microfinance: Developing Paths to Self-sufficiency.

Egyir, I.S.(2010), Rural Women and Microfinance in Ghana: Challenges and Prospects

Fofack, H(2005), Non Performing loans in sub-Saharan Africa : Causal Analysis and Macroeconomic implications, World Bank Policy Research Working Paper no. WP3769.

Gerald Pollio & James Obuobi(2010), Microfinance Default Rate in Ghana: Evidence from Individual Liability credit contract.

John Kay Associates Limited(2005), In-House Training in Accounting for non-accountants for credit officers.

Rouse, C.N (1989), Banker's Lending techniques, London Chartered Institute of Bankers.

Saunders M, Lewis P and Thornhill A.(2007), Research Methods for Business students(4th Edition)

Business Daily Africa(May, 2012)

First Allied S& L(2009-2010): Annual Report and Financial Statement

GHAMFIN ANNUAL REPORTS

Guidelines for Regulating Microfinance operations in Ghana, BOG(2011)

La Community Bank(2009-2010): Annual Reports and Financial statement

Pro Credit (2009-2010): Annual Report and Financial Statement.

SAT(2006-2010): Annual Reports and Financial statement.

SAT(2004) credit Policy

The Ghanaian Journal(Sept, 2010)

WEBSITES

bsd@bog.gov.gh[accessed 2012 March 19]

www.microfinanceinsight.com[accessed 2012 May 21]

www.scribd.com[accessed 2012 May 14]

http://teachmefinance.com/FinanceTerms/nonperformingloan.html[accessed 2012 April 10]

www.microcapital.org[accessed 2012 May 17]

www.mixmarket.org/mfi/sinapi-aba-trust[accessed 2012 August 4]

APPENDIX I

QUESTIONNAIRE FOR CREDIT STAFF AND BRANCH MANAGERS

The following questionnaire is meant for data collection for academic study. Your response to this questionnaire will be highly appreciated and treated with utmost confidentiality.

1.In your opinion, which of the following factors account for the incidence of non performing loans in your organization?

(i) Poor weather (ii) Business Failure

(iii) Poor credit appraisal (iv) Inadequate monitoring

(v) High interest rate (vi) Inadequate marketing avenues

(vii) Willful default (viii) Diversion of funds

(ix)Wrong timing of credit delivery (x) All of the above

`(xi) Others , please specify.

2. Do you think non-compliance with credit policy account for NPLs?

(a) Yes (b) No

3. If yes to above, which of the following account for that?

(a) Customer pressure

(b) Management pressure

(c) Ignorance of the requirements

(d) others, please specify ……………………………

4. How will you rank the following factors as causes of NPLs using a scale of 1 to 10, with 10 being the highest and 1, the lowest.

(i) Delayed approval [ ]

(ii) Poor credit appraisal [ ]

(iii) Diversion of funds [ ]

(iv) Business Failure [ ]

(v) Wrong timing of credit [ ]

(vi) Ineffective monitoring [ ]

(vii) Poor weather conditions [ ]

(viii) Inadequate marketing avenues [ ]

(ix) High Interest Rate [ ]

(x) Willful Default [ ]

(xi) Others, please specify[ ]

5.Which of the following factors hinder effective monitoring of loans?

(a) Staffing problem

(b) Lack of logistics

(c) Poor road network

(d) All the above

6.What are the causes of delayed loan approval?

(a) Rigid approval procedures

(b) Customers inability to meet approval requirement

(c) Insufficient loanable funds

(d) Poor credit appraisal

7.How do you price your loans/credit facility?

(a) Treasury Bill + risk premium

(b) Policy rate + risk premium

(c) Base rate + premium

(d) Average of the market

8. Do you have any formal training in credit appraisal?

(a) Yes (b) No

9.What type of security / collateral are often offered by borrowers to secure loans or overdraft?

(a) Landed property

(b) Cash (Fixed Deposit, S/A)

(c) Guarantee

(d) Other please, specify …………………………………….

10.Which of the following factors account for diversion of funds?

(a) Lack of proper monitoring

(b) Ignorance of lending terms and conditions

(c) Over financing

(d) Under financing

(e) Anticipation of windfall profits in other business areas

11.Which sector loan record the highest incidence of NPLs?

(a) Agriculture

(b) Trading

(c) Service

(d) Manufacturing

(e) others, please specify

12. Are there any particular reasons for your answer in above? Please specify ………………………………………………………………………………………………

13.What technique do you employ to monitor the health of loan portfolio?

(a) Ageing Analysis

(b) Portfolio at Risk (PAR)

14.How do you deal with problem loans?

(a) Legal Action

(b) Outsourcing (External solicitor/ Debt collectors)

(c) Write off

(d) Others please specify

15.What are the measures put in place by management to help reduce the incidence of NPLs?

(a) ____

(b)____

(c) ____

(d) ____

APPENDIX II-FINANCIAL STATEMENT- SINAPI ABA TRUST (2006-2010)

BALANCE SHEET					
MFI name	**Sinapi Aba Trust**	**Sinapi Aba Trust**	**Sinapi Aba Trust**	**Sinapi Aba Trust**	**Sinapi Aba Trust**
Annual Diamonds	3	5	3	4	4
Fiscal Year	**2006**	**2007**	**2008**	**2009**	**2010**
Period Type	**ANN**	**ANN**	**ANN**	**ANN**	**ANN**
As of date	12/31/2006 0:00	12/31/2007 0:00	12/31/2008 0:00	12/31/2009 0:00	12/31/2010 0:00
Assets	10028497.51	18589791.84	19534275.78	23123377.46	30667071.81
Cash and cash equivalents	429924.76	2126493.88	3472285.94	3613582.39	3345181.21
Trade and other receivables	493003.79	879582.65	1191146.88	1670352.82	5315702.01
Financial assets at fair value			994833.59		1339157.05
Financial assets available for sale	-	-	-	-	-
Other investments	1245625.52	1227632.65			
Net loan portfolio	7069750.83	13283629.59	12171849.22	15099090.85	18739253.02
Gross Loan Portfolio	7204123.14	13860817.35	13067769.53	15549485.92	19738325.5
Delinquency	-	-	-	-	-
Less than one month		13622092.86	12756472.66	15249490.14	19389208.72
One month or more	107055.82	238724.49	-	-	349116.78
From one to three months	25875.67	45657.14	79216.41	299995.77	224444.97
More than three months	-	-	-	-	124671.81
From three to six months	24575.01	21970.41	232026.56	0	124671.81
More than six months	-	-	-	-	0
From six to twelve months	56605.14	171096.94	0	0	0
One year or more	0	0	0	0	0
Renegotiated	0	0	0	0	-

loans					
Location	-	-	-		
Urban	-	-	-	7648101.41	10046807.38
Rural	-	-	-	7901384.51	9691518.12
Products (credit)	-	-	-	-	-
Loans to corporations	-	-	-	-	0
Loans to financial institutions	-	-	-	-	0
Loans to governments	-	-	-	-	0
Retail loans			13067769.53	15549485.92	18415778.52
Household financing	-	-	-	-	0
Consumption	-	-	-	-	0
Education	-	-	-	-	0
Mortgage housing	-	-	-	-	0
Household other	-	-	-	-	0
Microenterprise	-	-	13067769.53	15549485.92	18415778.52
Relationship	-	-	-	-	-
External customers	-	-	6924321.09	-	19738325.5
Management and staff	-	-	6143394.53	-	0
Methodology	-	-	-	-	-
Individual	-	-	958839.06	1636821.13	2049219.46
Solidarity group	-	-	12108876.56	5740933.8	7292594.63
Village banking s h g	-	-	-	8171730.99	10396511.41
Gender	-	-	-	-	-
Male	-	-	4050992.19	1945379.58	2435230.2
Female	-	-	9016723.44	13604106.34	17303095.3
Legal entity	-	-	-	-	0
Impairment loss allowance	134372.31	369718.37	379045.31	378157.04	0
Unearned income and discount			516874.22	72238.73	476210.07
Finance lease	-	-	-	-	-
Current tax assets	-	-	-	-	-
Deferred tax assets	-	-	-	-	-

Inventories	-	-	-	-	-
Intangible assets other than goodwill	-	-	-	-	-
Net fixed assets	790192.6	1072453.06	1704160.16	1757638.03	1927778.52
Liabilities and equity	10028497.51	18589791.84	19534275.78	23123377.46	30667071.81
Liabilities	5239553.56	12479467.35	12934917.19	15458394.37	20550653.02
Deposits	1755035.67	3348416.33	1528678.91	3295086.62	6085162.42
Gender	-	-	-	-	-
Male	-	-	-	381555.63	-
Female	-	-	-	2913530.99	-
Products (deposits)	-	-	-	-	-
Deposits from corporations	-	-	-	-	0
Deposits from financial institutions	-	-	-	-	0
Deposits from governments	-	-	-	-	0
Retail deposits	1755035.67	3348416.33	1528678.91	3295086.62	6085162.42
Voluntary deposits	384371.22	1003624.49	480810.16	1198847.89	1896270.47
Demand deposits	384371.22	1003624.49	480810.16	-	1896270.47
Time deposits	0	0	-	-	0
Compulsory deposits	1370664.44	2344791.84	932249.22	2096238.73	4188891.95
Borrowings	2622298.52	7734178.57	10120486.72	10762049.3	11889652.35
Subordinated debt	-	-	-	-	-
Other short term financial liabilities	-	-	-	-	-
Trade and other payables	862219.38	1396872.45	1053341.41	1335123.94	2400053.02
Provisions for employee benefits	-	-	-	-	-
Deferred revenue	-	-	-	-	-
Current tax liabilities	-	-	232410.16	66134.51	175785.23
Deferred tax liabilities	-	-	-	-	-
Equity	4788943.95	6110324.49	6599358.59	7664983.1	10116418.79

Paid in capital	0	0		0	232473.15
Retained earnings	3459274.32	3441335.71	4193976.56	4319554.93	5095390.6
Share premium	-	-	-	-	-
Treasury shares	-	-	-	-	-
Donated equity	823882.77	2668988.78	2405382.03	3101495.07	3770322.15
Equity reserves	376068.16	0	-	-	-
Other equity interest	129718.7	0	-	243933.1	1018232.89
Income Statement					
Start date	1/1/2006 0:00	1/1/2007 0:00	1/1/2008 0:00	1/1/2009 0:00	1/1/2010 0:00
Financial revenue	3024481.62	6003180	8406612.04	9942584.62	11655517.48
Interest and fee income	3017612.89	5985798.95	9176322.22	9286137.06	11537574.83
Revenue from interest	2409927.6	4956235.79	7690111.11	7597324.48	9417681.12
Interest income on loan portfolio	2374004.02	4864997.89	7666113.89	7572254.55	9292972.73
Products (credit)	-	-		-	-
Retail loans	-	-	7666113.89	7572254.55	-
Microenterprise	-	-	7666113.89	-	-
Interest income from investments	35923.58	91237.89	18245.37		124708.39
Other interest income	-	-	5751.85	25069.93	-
Fee and commission income	607685.29	1029563.16	1486211.11	1688812.59	2119893.71
Fee and commission income on loan portfolio	607685.29	1029563.16	1451088.89	1385080.42	2119893.71
Products (credit)	-	-	-	-	-
Retail loans	-	-	1451088.89	1385080.42	-
Microenterprise			1451088.89		
Income from penalty fees on loan portfolio	-	-	-	-	-

Fee and commission income from other financial services	-	-	-	-	-
Other fee and commission income			35122.22	303732.17	
Other operating income	6868.73	17381.05	126713.89	91950.35	289464.34
Gains (losses) on exchange differences on translation recognised in profit or loss	-	-	-961523.15	555778.32	-171521.68
Gains (losses) on disposals of property, plant and equipment	-	-	-	8718.88	-
Gains (losses) on financial assets	-	-	-	-	-
Gains (losses) on financial liabilities at fair value through profit or loss	-	-	-33268.52	-	-
Gains (losses) on held-to-maturity investments	-	-	-	-	-
Gains (losses) on loans and receivables	-	-	-	-	-
Gains (losses) on available-for-sale financial assets	-	-	-	-	-
Gains (losses) on financial liabilities at amortised cost	-	-	-	-	-
Gains (losses) on net monetary position					
Financial expense	353232.52	864793.68	1493910.19	2199060.14	2697802.8
Interest and fee	268441.63	864793.68	1493910.19	2199060.14	2697802.8

expense					
Interest expense			1493910.19	2199060.14	2697802.8
Interest expense on borrowings	-	-	1493910.19	2199060.14	2697802.8
Interest expense on deposits	-	-	-	0	0
Products (deposits)					
Retail deposits	-	-	403355.56	-	-
Compulsory deposits	-	-	403355.56	-	-
Interest expense on subordinated debt	-	-	-	-	-
Fee expense	-	-	-	0	0
Fee and commission expense on deposits	-	-	-	-	-
Fee and commission expense on borrowings	-	-	-	-	-
Other fee and commission expense	-	-	-	-	-
Other financial expense	84790.9	0	-	-	-
Net impairment loss, gross loan portfolio	107128.65	397402.11	113717.59	663063.64	169288.11
Impairment loss (reversal of impairment loss), gross loan portfolio	109356.86	399513.68	113754.63	663063.64	169288.11
Recoveries on loans written off	2228.21	2111.58	37.04	0	0
Operating expense	2257936.52	4122250.53	5258489.81	6314142.66	7406347.55
Personnel expense	1362045.41	2150555.79	2771100	2840003.5	4091677.62
Depreciation and amortisation expense	137376.86	197529.47	247884.26	324064.34	410137.76
Administrative	758514.25	1774165.26	2239505.56	3150074.83	2904532.17

expense					
Net operating income	306183.94	618733.68	1507225.93	838051.05	1382079.02
Non operating income	-5229.83	0		98428.67	0
Net Income before taxes and donations	300954.11	618733.68	1507225.93	936479.72	1382079.02
Tax expense	86096.25	534064.21	361923.15	158953.15	362244.06
Net Income after taxes and before donations	214857.86	84669.47	1145302.78	777526.57	1019834.97
Donations	528452.2	1954478.95	214583.33	0	0
Net income after taxes and donations	743310.06	2039148.42	1359886.11	777526.57	1019834.97