

**THE DETERMINANTS OF LOAN CONTRACT TERMS IN MICRO FINANCE
INSTITUTIONS: A CASE STUDY OF GARDEN CITY SAVINGS & LOANS
LIMITED**

By

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KNUST

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Certification

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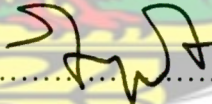
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Abstract

Improving the availability of credit facilities to Small and Microenterprises (SMEs) is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the economy. Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, have not been addressed. Against this background, the research work sought to determine the lending terms in MFIs and how it will impact on the lives of individuals using Garden City Savings and Loans Ltd as a case study. The research work portrayed that most SMEs are able to provide the needed collateral to secure loans largely in the form of personal savings. Notwithstanding, there was a positive correlation between customers creditworthiness and their past records and accounts operations as a basis of assessment. However majority of the customers were unanimous in requesting for some grace period before the repayment of the principal loan commences. In conclusion, Micro Finance Institutions (MFIs) have developed mechanisms where borrowers form groups which jointly share liability for loan delinquencies or default. The incentives set by such contracts enable the lender to reduce his cost of screening, monitoring and enforcement.

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 BACKGROUND OF STUDY

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. Microfinance refers to provision of small loans and other facilities like savings, insurance, and transfer services to poor low-income household and micro enterprises. Micro credit also refers to a small loan to a client made by a bank or other institutions.

The concept of microfinance is not new in Ghana. Traditionally, people have saved with and taken small loans from individuals and groups within the context of self-help to start businesses or farming ventures. Available evidence also suggests that the first Credit Union in Africa was established in Northern Ghana in 1955 by Canadian Catholic Missionaries. Susu, which is one of the current microfinance methodologies, is thought to have originated in Nigeria and spread to Ghana in the early 1990s. Microfinance has gone through four (4) distinct phases worldwide of which Ghana is no exception. These stages are described below:

Phase One: The provision of subsidized credit by Governments starting in the 1950's when it was assumed that the lack of money was the ultimate hindrance to the elimination of poverty.

Phase Two: Involved the provision of micro credit mainly through NGOs to the poor in the 1960's and 1970's. During this period sustainability and financial self-sufficiency were still not considered important.

Phase Three: In the 1990's the formalization of Microfinance Institutions (MFIs) began.

Phase Four: Since the mid 1990's the commercialization of MFIs has gained importance with the mainstreaming of microfinance and its institutions into the financial sector.

In Ghana, the term microfinance is understood as a sub-sector of the financial sector, comprising most different financial institutions which use a particular financial method to reach the poor. Microfinance sector in Ghana comprises 4 various types of institutions and these have been grouped into four (4) categories, namely:

- 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.
- Public sector programmes that have developed financial and non financial services for their clients.

The main goal of Ghana's Growth and Poverty Reduction Strategy (GPRS II) is to ensure "sustainable equitable growth, accelerated poverty reduction and the protection of the vulnerable and excluded within a decentralized, democratic environment". The intention is to eliminate widespread poverty and growing income inequality, especially among the productive poor who constitute the majority of the working population. According to the 2000 Population and Housing Census, 80% of the working population is found in the private informal sector. This group is characterized by lack of access to credit, which constrains the development and growth of that sector of the economy. The observation was stressed in the International Monetary Fund Country report on Ghana of May 2003

that “weaknesses in the financial sector that restrict financing opportunities for productive private investment are a particular impediment to business expansion in Ghana.”

Microfinance is perceived as a financially sustainable instrument meant to reach significant number of poor people of which most are not able to access financial services because of the lack of strong retailing financial intermediaries. Access to financial services is imperative for the development of the informal sector and also helps to mop up excess liquidity through savings that can be made available as investment capital for national development (World Bank- Africa Region, 1999). Microfinance as a sector has the potential to reduce poverty by bringing a significant improvement in the lives of the active poor who are largely women.

1.2 STATEMENT OF THE PROBLEM

Small-scale enterprises have become an important contributor to the Ghanaian economy. The sector contributes to the national objective of creating employment opportunities, training entrepreneurs, generating income and providing a source of livelihood for the majority of low income households in the country. Yet the majority of entrepreneurs in this sector are considered uncreditworthy by most formal credit institutions. Whereas a number of MFIs finance an increasing number of microenterprise activities, most formal institutions still deny these enterprises access to their services.

Improving the availability of credit facilities to this sector is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the economy (ROK, 1994). Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, have not been addressed. In addition, there is no empirical study indicating the

potential role of improved lending policies by both formal and informal credit institutions in alleviating problems of access to credit. Knowledge in this area, especially a quantitative analysis of the effects of lending policies on the choice of credit sources by entrepreneurs, is lacking for the rural financial markets of Ghana.

Although informal credit institutions have proved relatively successful in meeting the credit needs of small enterprises in some countries, their limited resources restrict the extent to which they can effectively and sustainably satisfy the credit needs of these entrepreneurs (Nappon and Huddleston, 1993). This is because as microenterprises expand in size, the characteristics of loans they require become increasingly difficult for informal credit sources to satisfy, yet they still remain too small for the formal lenders (Aryeetey, 1996a). Studies on financial markets in Africa have shown that credit markets are segmented and unable to satisfy the existing demand for credit in rural areas. Whereas for informal markets it is the limited resources that bring the constraint, for the formal sector it is the difficulty in loan administration that is the problem. This research work sought to determine the lending terms in MFIs and how it will impact on the lives of individuals.

1.3 OBJECTIVES OF STUDY

The main objective of this study was to determine the loan contract terms of MFIs a case study of Garden City Savings & Loans Ltd.

The specific objectives were:

- to examine the ability of loan applicants to provide needed collateral to secure loans.
- to assess the credit worthiness of loan customers.
- to ascertain the capacity of GCSL to meet the loan request of customers.

1.4 SIGNIFINANCE OF THE STUDY

This study will serve as a guide to management of GCSL in determining future loan contract terms.

It will help how the operations of GCSL will be used to help as a guiding tool for the effective formulation of policy in the micro and small sector access to loans and the terms of the loans as a measure to mitigate the negative impact associated with most formal credit institutions.

Furthermore, the significant of the study is to understand GCSL's loan contract terms and then to use that as a basis for comparative analysis and study in future operations in MFIs.

1.5 OVERVIEW OF METHODOLOGY

The study was based on both primary and secondary data sources in the forms of questionnaires and personal interviews of loan officers and loan customers. Monthly and annual reports on loans and corporate plan of GCSL were obtained for the study.

The methodology was grouped into two (2) categories:

- i) data collection
- ii) data analysis

1.5.1 Data Collection

The research was based on two categories of data collection. They are primary and secondary.

a. Primary data collection

These were based on personal interviews and questionnaires from managers and officers of the loans department of GCSL and their loans customers.

b. Secondary data source

Secondary sources such as GCSL management reports and loans contract terms, financial statement of customers, Bank of Ghana's (BOG) on-site and off-site reports, corporate plan of GCSL, Ghana Microfinance Institutions Network (Ghamfin) reports, Internet and other publications were used to gather information on MFIs on loans contract terms.

1.5.2 Data Analysis

Statistical Package for the Social Sciences (SPSS) was used to analyze data. Tables and graphs were used to represent the data analyzed.

1.6 SCOPE OF STUDY

The scope of the study was limited to Kumasi. GCSL was used as a case study. It covered all branches of GCSL in Kumasi.

1.7 ORGANIZATION OF THE STUDY

The main body of the dissertation is structured as follows:

Chapter One

This introduced the study stating the problem, objectives and gives a background MFIs in Ghana and their contributions to the economic growth and development of small and micro enterprises.

Chapter Two

This reviewed literature on loans contract terms and customers readiness to comply with the terms and their effect on the growth of world-wide MFIs.

Chapter Three

This chapter focused on the methodology, historical background, organizational set-up and the performance of the loans portfolio of GCSL.

Chapter Four

The chapter analyzed the data collected on GCSL and their customers on loans contract terms.

Chapter Five

The chapter discussed conclusions and recommendations and as well distilled some policy lessons.

1.8 Limitations Of The Study

A lot of constraints were encountered in this project work. First of all, Ghanaian companies' are less transparent with information. The success of getting the needed information will also depend highly on the goodwill of the officials involved and the level of confidence they will have in me that information divulged would not be disclosed to their competitors.

Time constraint was another factor as a lot of time was used in search for the gathered information as they were completely scattered.

CHAPTER TWO

2.1 BACKGROUND ON MICROFINANCE IN GHANA

2.1.1 Macroeconomic and Policy Environment

Ghana has a population of about 18 million, which has been growing at about 3% per year according to The World Bank, Financial Sector Development Department (November 2001). Recent statistics (1999-2000) indicate that 63% of the population lives in rural areas and 37% in urban areas. Gross domestic product (GDP) stood at US\$7.558 billion, with an annual growth rate of 4.5%. However, inflation has continued to be a problem: the end-of-period inflation rate was 13.8% in 1999, and estimated at 23.0% in 2000. Ghana's per capita GNP of US\$390 is much lower than the average per capita income level of US\$520 for Sub-Saharan Africa. Ghana's financial structure is fairly shallow: the degree of monetization of the economy, as measured by the M2/GDP ratio, stands at 19%. Because the level of international reserves stands at only 1.5 months of imports, Ghana's economy is markedly vulnerable to external shocks.

Ghana has focused on poverty reduction as the core of its development strategy. This approach galvanized in 1995 when the first version of *Ghana - Vision 2020* was launched and institutional arrangements began to be put in place to promote and analyze poverty reduction. The Government had prepared (as of July 2000) a *Development Strategy for Poverty Reduction*, an Interim Poverty Reduction Strategy Paper (Interim PRSP) to take up with the World Bank and the IMF.

The overall policy framework for microfinance is informed by the poverty reduction strategy, which seeks to balance growth and macroeconomic stability with human development and empowerment in such a way as to positively impact the reduction of the

country's poverty levels in the medium term. The strategy identifies the main sources of poverty, and aims to explicitly measure all sectoral strategies and programs in terms of the extent to which they contribute to reducing poverty.

The overall strategy emphasizes the reduction of inflation and the need to sharply reduce the fiscal deficit, as a key step to reduce the extent of the public sector's crowding out of the private sector in the financial markets, and to help lower interest rates.

2.1.2 Poverty in the Ghanaian Context

From a level of 51% of the population in 1991-1992, poverty in Ghana has decreased to about 43% of the population living below Ghana ₵900,000 in 1998. Still, the average consumption level of the poor in Ghana is about 30% below the upper poverty line of Ghana ₵900,000. The reductions in poverty levels have tended to be concentrated in the Accra area and in the Rural Forest localities.

Poverty is higher in rural areas (51.6 %) than in urban areas (22.8%): more than one-half of the population living in the Rural Savannah regions continues to be extremely poor. Poverty is highest among the self-employed households cultivating agricultural crops and has decreased only slightly, compared to the self-employed households engaged in export-crop agriculture and the wage employees in the public and private sectors.

2.1.3 Structure of the Microfinance Sector

Ghana has a tiered range of formal, semi-formal and informal institutions providing microfinance services to the urban and rural poor and underserved sectors of the economy. Financial intermediation and credit activities are under the regulatory jurisdiction of the Bank of Ghana (BOG). The regulatory framework under the Banking

Law (1989) and the Non-Bank Financial Institutions (NBFI) Law (1993) accommodate a tiered structure of licensed financial intermediaries and of financial regulation.

The formal sector institutions providing microfinance services consist of Rural Banks, Savings and Loan (S&L) companies and Credit Unions. Rural Banks are public companies owned by communities (with capitalization assistance from the BOG), registered and licensed as unit banks (no branching privileges) under the provisions of the Banking Law. The operations of Rural Banks are limited to a clearly-defined geographical (rural) area, and are permitted to offer banking services limited to loans and to checking, savings and time deposits. Moreover, the ownership and voting control structures of Rural Banks resemble credit unions because of their one share-one vote structure. In contrast, private individual parties own the S&L Companies, which are registered and licensed under the NBFI Law and are permitted to offer banking services limited to loans and to savings and time deposits. Unlike the Rural Banks, ownership and control structures of S&L companies (which, like commercial banks, have branching privileges) follow cumulative shareholding positions. The minimum capitalization requirements at entry for both Rural Banks (US\$20,000) and S&L companies (US\$50,000) are significantly lower than the levels set for commercial and development banks.

The Credit Unions which are mutually-owned cooperative associations of individual members are registered under the Law on Cooperatives and subject to regulation by the Credit Union Supervisory Board, a government agency. They are also required, under the NBFI Law, to be registered and licensed by the BOG. A number of NGOs, organized by private parties as trust entities or charitable institutions under the provisions of the Law on Trusts and Charitable Institutions, provide both micro loans and non financial services

to their client-base, without being subject to regulation or supervision by external government agencies. The majority of microcredit NGOs belongs to an umbrella organization - Ghana Micro Finance Network (GHAMFIN) - which provides staff training and organizational capacity-building assistance and disseminates best practice guidelines and standards for governance, operations and performance efficiency.

There are a large number of *susu collectors* in the informal sector, who provide collection and safekeeping services for the savings of mostly women market-vendors and operators of micro enterprises. Technically, *Susu collectors* are not involved in intermediating the aggregate savings which they collect and manage into loans. However, the women market vendors and micro enterprise operators have been able to access "loans" from their own *susu collectors* in the form of "advance draw-downs" against the total amount of savings they have contracted to deposit weekly for a set period. In most cases, these advances have been made possible by commercial and development banks, rural banks, and S&L companies with which the *susu collectors* deposit the savings funds they collect and manage. There were indications that the "advance draw-down" feature had been introduced as a response to increasing competition among *susu collectors* for the savings of the market vendors and micro enterprise operators

A variation on the *susu* collection system is the *susu club*, wherein the members - the women market vendors and micro enterprise operators go to a designated place on a scheduled day of the week to make their savings deposits with the *susu collector* who runs the *susu club*. The set-up allows a *susu collector* to service the savings deposit safekeeping needs of a much larger number of clients.

Individual *susu collectors* and *susu clubs* are neither registered nor licensed by any government agency, although there is a rapidly growing number of individual susu collectors who belong to cooperative associations of collectors (e.g., the National Association of Susu Collectors or the Greater Accra Association of Susu Collectors), which have taken steps to establish accreditation and identification procedures for their members as well as a form of deposit protection for the clients of their collector-members who would surely suffer losses in the event of nonperformance due to death or defalcation by a *susu collector*. *Susu collectors* would have an average of 150-200 women market vendors and micro enterprise operators as clients, while susu clubs may have as many as 400-500 women market vendors and micro enterprise operators as clients.

Traders, input-suppliers, money-lenders, rotating savings and credit associations (ROSCAs), and accumulating savings and credit associations (ASCAs) constitute the informal segment of the market for microfinance in Ghana.

2.2 Legal and Regulatory Framework for Microfinance

2.2.1 Highlights of the Legal Structure and Judicial System.

Except for susu collectors, susu clubs, ROSCAs and ASCAs, MFIs in Ghana are required to establish legal entity. Banks and NBFIs (which include rural banks and S&L companies) are required to be incorporated entities under the Companies Act. Credit unions have legal status and identity through registration under the Cooperative Societies Act as well as the requirements of the NBFIs Law. NGOs, including those with microcredit orientation, have legal status through establishment under the provisions of the Law on Trusts and Charitable Institutions and the required registration with the Ministry of Employment and Social Welfare.

Ghana's legal structure and judicial system needs to be further modernized and upgraded (i) to facilitate creation/registration/execution of lender's security interests on pledged collateral, (ii) eliminate duplicate/multiple pledging of collateral, and (iii) facilitate introduction of securitized financial instruments that can benefit microfinance development through better connection and linkages to formal sector institutions and financial markets. These modernizing improvements will be beneficial not just to the development of sustainable microfinance, but for the formal financial sector as well. As the experience of other countries (e.g., Romania) has demonstrated, reforming the legal and regulatory frameworks for financial transactions secured with movable assets has a substantial favorable impact on expanding access to markets for rural credit and microfinance. For Ghana, such reforms would need to be accompanied by a significant reduction in government programs that can crowd out sustainable microfinance by private sector institutions.

2.2.2 Highlights of the Regulatory Framework.

In Ghana, a tiered structure of institutions and graduated regulation for microfinance existed even before the Government gave formal recognition to microfinance in 1999 and through new BOG regulations pertaining specifically to microfinance.

The newly-adopted formal policies on microfinance and the adoption of a regulatory framework specific to microfinance activities had parallel co-existence with an existing credit-quota system for agricultural credit and SME finance. The regulatory (and tax) preferences enjoyed by rural banks and credit unions in combination with the operation of a graduated/tiered system have made it possible for NGO MFIs to transform into licensed institutions. This has been an indispensable element for substantially expanding

the ability of MFIs to mobilize financial resources beyond traditional grants and donations.

However, the remaining traditions of the former credit quota system can be detrimental to microfinance, and further policy clarification on this aspect is indispensable. The BOG continues to coordinate closely with GHAMFIN and with the Ghana Credit Union Association (CUA) to develop regulatory standards that can help promote institutional growth of the microfinance industry, and is seriously considering ways to simplify prudential standards/guidelines. A further development that bears watching is the establishment of a Government-sponsored and supported apex institution for rural banks. The experience elsewhere has shown that government-promoted apex organizations pose a significant risk of distorting the allocation of scarce financial resources and competing unfairly against private MFIs because of access to subsidized resources, thereby retarding the development of truly sustainable microfinance.

The Rural Banks, S&L companies, Credit Unions which are registered with and licensed by the BOG are not directly included in the central clearing and payments system. They participate in the central systems for clearing and payments through the larger commercial banks. BOG cancelled check clearing services for all rural banks in 1992, which has made it extremely difficult for even the better rural banks to effectively compete in the marketplace, retain their clientele, and lower their operating costs. Neither do Rural Banks have access to BOG's discount window nor are all of them subject to identical loan-to-deposit ratio requirements.

Credit unions are currently regulated under a self-regulatory mode, in the interim that a separate set of prudential norms and guidelines specific to credit unions is being put together by the NBFIBOG. In addition, credit unions approved for licensing by BOG have to comply with and meet the prudential standards set by the CUA, whose vetting is pre-requisite to BOG licensing. The prudential norms followed by the CUA, which is supported by the Canadian Cooperative Association (CCA), are similar to operating and financial standards promoted by the World Council of Credit Union (WOCCU).

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2.2.3 Prudential standards.

The risk management criteria considered by BOG as important for MFIs and the adjustments made to recognize characteristics of microfinance operations are discussed below.

- **Capital adequacy.** The minimum capitalization requirements for licensed MFIs - S&L companies and Rural Banks - are significantly lower than those for commercial banks and long-term development banks. S&L companies are required to have a paid-up capital of US\$50,000 while Rural Banks are required to have US\$20,000 in paid-up capital. The solvency standard established by BOG for these licensed financial institutions is unimpaired capital equivalent to at least 6% of risk assets for Rural Banks and 10% of risk assets for S&L companies. There are indications that a significant number of Rural Banks, and S&L companies have capital adequacy deficiencies - largely because of unfavorable operating guidelines (e.g., on secondary reserves) that had to be adhered to, rapid growth in loan portfolios even as this growth was being accompanied by increases in non-performing loans and inadequate provisioning. Nonetheless, it

seems clear that capital adequacy levels need to be reviewed periodically for appropriate adjustments.

- **Mandatory liquidity reserves.** BOG prescribes the primary and secondary reserve assets that licensed deposit-taking institutions are required to hold, relative to an institution's total deposit liabilities. Currently, BOG requires all Rural Banks to maintain a prohibitively high secondary reserve of 52% of deposit liabilities' 2 (but S&L companies are required to maintain a comparatively lower secondary reserve of 15% of deposit liabilities) to be held in government debt instruments, Treasury Bills. While the high secondary reserve requirement might have been intended to strengthen these smaller financial institutions, the regulations do not distinguish between stronger vis-a-vis weaker MFIs and thereby penalizes the more efficient and stronger institutions. BOG classifies Rural Banks into a number of categories - e.g., satisfactory, mediocre and distressed - which could easily form a basis for a more fair and effective system of rewards and penalties for acceptable financial performance. The high level of mandatory secondary reserves significantly increases the funding costs for microfinance loans.

- **Security for loans.** Current prudential guidelines require licensed banks to obtain physical assets to secure loans. While formal sector banks and financial institutions have begun to accept treasury bills and deposit balances as acceptable collateral, these options are clearly beyond the reach of poor households in the rural and urban areas. Close coordination between the Ministry of Finance, BOG and GHAMFIN have led to a better understanding of the characteristics of

microfinance loans and, possibly, formalizing the status of group guarantees as acceptable collateral in microfinance loans.

- **Recognition and classification of delinquent loans.** 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 micro enterprise 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 monthly 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 loans accounts.
- **Provisioning for portfolio at risk.** 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 arrearage basket, without regard to any security available for individual loans. The prescribed rate of provisioning for microfinance and small business loans is shown below:

Number of days delinquent	Rate of provisioning
Up to 30 days	5%
30 days and less than 60 days	20%
60 days and less than 90 days	40%
90 days and less than 120 days	60%
120 days and less than 150 days	80%
150 days and above	100%

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 1% of the aggregate outstanding of all the current or standard class of loan assets. Financial institutions are also required to separately disclose, in their financial accounts and reports, the specific and general loss provisions made for non-performing delinquent loans and standard/current loan assets.

- **Guidelines and standards for writing-off of non-performing loans.** The general practice among licensed MFIs is to write off non-performing or delinquent loans at the time that the loan loss is confirmed. It does not appear that BOG has specified a procedure covering the mandatory writing off of non-performing loans. A standard procedure and timing that triggers off mandatory write-off would obviously be impacted by the ability (or lack thereof) of MFIs to comply with capital adequacy and loan loss reserve requirements.

2.3 Loan Terms

How loan repayment is structured is of central importance to both borrowers and lenders.

Loan terms describe the process of loan repayment in terms of price and time. The terms of a loan include:

- Time elements:

- Duration of loan contract
- Repayment intervals
- Grace period (time between loan disbursement and first repayment)

➤ Price elements:

- Interest payments
- Amount of forced savings, if required
- Fees and commissions

The loan terms determine both the yield on an MFI's portfolio and the real cost to the borrower. One of the most critical elements is the amount and structure of interest payments. As is demonstrated below, a quoted interest rate of 3%, for example, may generate dramatically different levels of interest income depending on how interest payments are calculated.

2.3.1 Calculating Interest Payments

The amount that a borrower pays to a lending institution in interest is determined not only by the stated interest rate but also by the method used to calculate interest. Two general techniques are widely used: the declining balance method and the "flat" method. The declining balance method imposes lower costs on the borrower than does the flat method. Equivalently, the declining balance method generates lower yield on an MFI's portfolio than does the flat method. In the following sections, we will consider examples of interest calculated using these two methods. For simplicity, we will ignore present value considerations and we will assume that when a weekly or monthly rate is annualized, an "Annual Percentage Rate" (APR) method is used (compounding is not taken into account).

2.3.2 Declining Balance Method

When the declining balance method is used, interest is computed based on the balances that remain in the borrower’s hands. As successive installments of principal are repaid, these balances decline. In this case, interest is not charged on the amount of the loan principal that the borrower has already repaid. Consider the following example of a 3 month, \$300 loan to be repaid in 6 equal monthly installments, calculated on declining balances. The payment made each period (PMT) is \$53.56. In the early periods when the outstanding balance is high, the contribution of interest to the PMT is relatively high and the contribution of principal repayment to the PMT is relatively low. As the principal balance declines, the contribution of interest payments to the PMT declines as well.

Table 1: Declining Balance Method

Loan amount: \$ 300; Loan term: 3 months; Loan repayment period: every 2 weeks; annual interest rate: 48 percent

Period	Principal	Interest	Total payments	Outstanding balance
0				300
1	47.56	6	53.56	252.44
2	48.51	5.05	53.56	203.93
3	49.48	4.08	53.56	154.45
4	50.47	3.09	53.56	103.99
5	51.48	2.08	53.56	52.51
6	52.51	1.05	53.56	0.00
TOTAL	300	21.35	321.35	-

In this declining balance example, total payments by the borrower are 321.35.

2.3.3 Flat Method

When the flat method is employed, interest is computed based on the original face amount of the loan rather than on the declining balances. Computing interest using the flat method instead of the declining balance method has the effect of raising the payment made each period, and, therefore, increasing the “effective” interest rate to the borrower. This means that the loan is more costly to the borrower and, equivalently, that the loan generates more income for the lending institution. Consider the same example as last time, except now interest is calculated using the flat method. In this case, the contribution of interest payments to the PMT is constant: in each period, the borrower repays \$50 in principal and \$6 in interest. Here, the payment made each period is \$56, which is less than the PMT of \$53.56 in the declining balances case. The total payments made by the borrower in the flat rate case are \$336.

Table 2: Flat Method Loan amount: \$ 300; Loan term: 3 months; Loan repayment period: every 2 weeks;
Annual interest rate: 48 percent

Period	Principal	Interest	Total payments	Outstanding balance
0	-	-	-	300
1	50	6	56	250
2	50	6	56	200
3	50	6	56	150
4	50	6	56	100
5	50	6	56	50
6	50	6	56	0
TOTAL	300	36	336	-

All else equal, total payments by the borrower when interest payments are calculated using the flat method are greater than total payments when interest payments are calculated using the declining balance method. Therefore, the flat method generates more revenue for the lending institution and imposes higher costs on borrowers.

2.3.4 The Effective Interest Rate

The effective interest rate is the rate that a client is “really” paying, based on the amount of loan proceeds actually in the client’s hands during each period of the life of the loan.

The formula to calculate the effective interest rate is:

$$\text{Effective Interest Rate} = \frac{\text{Total interest and fees}}{\text{Average balance outstanding}} \times \frac{\text{Periods in a year}}{\text{Periods in the loan term}}$$

Using this formula, we will compute the effective interest rates implied by the two previous examples of declining balance and flat interest rates on otherwise identical loans.

Declining balance case:

In the declining balance case, interest payments totaled 21.35, the average balance is 177.9, there are 12 months in a year and 3 months in the loan period.

$$\text{Effective interest rate} = (21.35/177.9) \times (12/3) = 0.48$$

In the case of declining balance interest rate calculations (without fees, upfront interest payments, or compulsory savings), the effective interest simply equals the annualized interest rate.

Flat rate case:

In the flat rate case, interest payments totaled 36 and the average balance was 175.

$$\text{Effective interest rate} = (36/175) \times (12/3) = 0.82$$

All else being equal, the effective interest rate is higher in the case of a flat rate than in the case of interest computed on declining balances.

2.3.5 Other Factors that Determine Effective Interest Rates

A lending institution can increase the effective interest rate of a loan (and increase the portfolio yield) by changing any of the following factors:

- Requiring that a portion of the loan be deposited as compulsory savings prior to or after loan disbursement.
- Requiring payment of interest at the beginning of the loan, as a deduction from the amount of principal disbursed to the borrower. For example, take the declining balances case described in Table 1.
- Charging an initial fee or commission in addition to the interest
- Requiring more frequent payment of principal and interest-

Consider the following example of a \$300, 3 month loan with flat 48% annual interest and a fee of 3%.

Table 3: Flat rate with fee

Loan amount: \$ 300; Loan term: 3 months; Loan repayment period: every 2 weeks;
Annual interest rate: 48 percent; Fee=\$10.

Period	Principal	Interest	Total payments	Outstanding balance
0	-	10	10	290
1	50	6	56	240
2	50	6	56	190
3	50	6	56	140
4	50	6	56	90
5	50	6	56	40
6	50	6	56	-
TOTAL	300	46	346	-

In this case, the total interest payments are 46 and the average balance is 165. Therefore, the effective interest rate is $(46/165) \times (12/3) = 1.12$. In the case without the upfront fee, the effective interest rate is 82%. With an up-front fee of \$10, the effective interest rate is 112%. This example demonstrates that requiring an up-front fee raises the effective interest rate.

2.3.6 Setting Interest Rates

How should an MFI decide what prices to charge its clients? In order to achieve financial sustainability, program income must cover all programmatic and financial costs. For most MFIs without other assets that provide income, this means that interest income from loans must cover all costs. Therefore, the following are important factors to consider when an MFI decides an interest rate:

- Administrative expenses include; rent and utilities, salaries, travel and transportation, office supplies, etc.
- Inflation and depreciation

- The cost of loan losses
- The cost of the funds that the MFI borrows.

2.3.7 Nominal verse Real Interest Rates

The interest rate charged to borrowers is usually called the *nominal interest rate*. This may be different from the *real interest rate*, which is approximately calculated as follows:

$$\text{Real Interest Rate} = \text{Nominal Interest Rate} - \text{Rate of Inflation}$$

If the nominal interest rate is higher than the rate of inflation, then the real interest rate is positive. For borrowers, a positive interest rate means that they have actually paid something for the benefit of using the money that they have borrowed. In order for the loan fund to maintain its value, it is essential for an MFI to charge a nominal rate of interest that is greater than the rate of inflation.

2.3.8 A Sustainable Interest Rate

The Consultative Group to Assist the Poorest (CGAP) has designed a straightforward method to allow MFIs to determine what effective interest rate they need to charge in order to achieve financial viability. Below is an overview of the computation. The interest rate required for financial sustainability (R) is determined by five elements, each expressed as a percentage of the average outstanding loan portfolio:

- **administrative expense rate (AE)**, calculated by dividing total annual administrative expenses by average outstanding loan portfolio;
- **targeted capitalization rate (K)**, the net real profit that the MFI decides to target, divided by the average loan portfolio;

- **loan loss rate (LL)**, calculated by dividing annual loss due to uncollectible loans by average outstanding loan portfolio;
- **the market cost of funds rate (CF)**, for details on calculation, see the CGAP paper; and
- **investment income rate (II)**, the income expected from an MFI's financial assets other than the loan portfolio, divided by the average loan portfolio. In general, health MFIs have administrative expense rates between 10-25%, targeted capitalization rates between 5-15%, and loan loss rates between 1-2%. R, the minimum required annualized effective interest rate for financial sustainability, is calculated as follows:

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

The CGAP paper provides the following example for the interest rate calculation for a hypothetical MFI:

- Administrative expense rate = .25
- Targeted capitalization rate = .16
- Loan loss rate = .02
- Cost of funds rate = .21
- Investment income = .015

In this example, $R = (.25 + .16 + .02 + .21 - .015) / (1 - .02) = .638$.

2.4 Access to financial services

Access to financial services by smallholders is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan

amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt and Kropp, 1987). For small-scale enterprises, reliable access to short-term and small amounts of credit is more valuable, and emphasizing it may be more appropriate in credit programmes aimed at such enterprises. Schmidt and Kropp (1987) further argue that the type of financial institution and its policy will often determine the access problem. Where credit duration, terms of payment, required security and the provision of supplementary services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when they do, they will be denied access.

The Grameen Bank experience shows that most of the conditions imposed by formal credit institutions like collateral requirements should not actually stand in the way of smallholders and the poor in obtaining credit. The poor can use the loans and repay if effective procedures for disbursement, supervision and repayment have been established.

On the issue of interest rates, the bank also supports the view that high interest rate credit can help to keep away the influential non-target group from a targeted credit programme (Hossain, 1988). This further demonstrates the need to develop appropriate institutions for the delivery of loans to small-scale borrowers. Notable disadvantages of the formal financial institutions are their restriction of credit to specific activities, making it difficult to compensate for losses through other forms of enterprises, and their use of traditional collateral like land. There is need for a broad concept of rural finance to encompass the financial decisions and options of rural economic units, to consider the kind of financial services needed by households, and which institutions are best suited to provide them.

2.5 Loan screening, monitoring and contract enforcement

Unlike formal finance, informal lenders often attach more importance to loan screening than to monitoring the use of credit. Screening practices often include group observation of individual habits, personal knowledge by individual moneylenders and recommendations by others, and creditworthiness. In group lending programmes, members are made jointly liable for the loans given. The joint liability plus the threat of losing access to future loans motivates members to perform functions of screening loan applicants, monitoring borrowers and enforcing repayment. Investigations of the effect of intragroup pooling of risky assets show that groups exploit scope and scale economies of risk by pooling risks and entering into informal insurance contracts. This confirms the role of social cohesion in group repayment (Zeller, 1998).

In group lending, the financial intermediary reduces the recurrent transaction costs by replacing multiple small loans to individuals by a large loan to a group. This enables financial intermediaries to bank with poor loan applicants who would not receive any loans under individual loan contracts due to excessive unit transaction costs. One of the most important rationales for group lending is the information and monitoring advantages that member based financial institutions have compared with individual contracts between bank and borrower. The main argument in the rationale is that in comparison with distant bank agents, group members obtain information about the reputation, indebtedness and wealth of the applicant. They are also able to use social sanctions to compel repayment. However, it has been shown that a number of factors may undermine repayment performance of group lending under joint liability. These include reduced repayment incentives for individual borrowers where other members default, and the incentive to borrow for riskier projects under group based contracts. There are strong

incentives for individuals with similar risk characteristics to form credit groups (Zeller, 1998), while other scholars have indicated that group lending schemes work well with groups that are homogeneous and jointly liable for defaults (Huppi and Feder, 1990).

Little evidence exists showing substantial investment in loan monitoring by informal lenders. Aryeetey and Udry (1997) conclude that the observation that commercial lenders spend more time screening new applicants than on monitoring activities of current borrowers suggests that they are more concerned with adverse selection than moral hazard.

2.6 The Risk of the Bank

The ability to provide liquidity is a special function of banks (see Rajan (1996), Diamond and Rajan (1999), and Kashyap et al. (2000)). In providing liquidity services, banks are exposed to liquidity risk from unexpected withdrawals of deposits or unexpected take-downs of loan commitment facilities. However, the risk may be limited by banks shortening the maturity of their assets/loans. Moreover, Hubbard et al. (2002) argue that a riskier bank, as measured by a lower capital-assets ratio, has a lower recovery rate in default and therefore charges a higher premium. Because the bank-borrower relationship reduces information and incentive costs, it is costly for borrowers to switch out of bank relationships. Hence an idiosyncratic increase in the bank's cost of funds from a decrease in capital increases the cost of funds to the borrower.

Thus, we hypothesize that riskier banks will charge higher loan yield spreads and make shorter maturity loans. We use several alternative proxies for lead bank risk including measures of capital adequacy, and credit and liquidity risk. For capital adequacy we use

the capital to assets ratio, denoted *Capital Ratio*, which is inversely related to bank risk, and the *Low Capital* indicator variable as used by Hubbard et al. (2002) that takes a value of one if the capital ratio is less than some threshold and zero otherwise. As a proxy for credit risk we use the *Loan Loss Ratio* measured as loan charge offs divided by total loans. Finally we use three alternative proxies for liquidity risk, the *Loan/Deposit Ratio*, the *Cash/Assets Ratio*, 5 and the bank's *Brokered Deposits Ratio*. The capital and cash/assets ratios are inversely related to bank risk and thus are expected to be directly related to loan maturity and inversely related to the spread. On the other hand, as the low capital indicator variable, loan loss ratio, loan/deposit ratio, and brokered deposits ratio are directly related to bank risk they are expected to be inversely related to loan maturity and directly related to the yield spread.

2.7 Credit History

The effect of credit history on the sovereign debt market has been analyzed quite extensively in the theoretical literature. In general, one can distinguish two channels through which credit history affects the sovereign debtor. One is what could be called a “pure reputation” effect and the other the increased probability of default. The first one means an increase in spread or a denial of a loan without any implication coming from the future default probability. There are several lines of research that obtain this “punishment” result.

One, pioneered by Eaton and Gersovitz (1981), points to the need for the borrower to access the credit markets repeatedly as a motivation for a sovereign borrower to repay their debts. In these models, the sovereign borrower will be excluded from the world credit market once they repudiate their debt obligations. A more relevant theoretical

contribution from the perspective of our paper is that of Wright (2002). He proves that if one considers the possibility of syndicated loans, in which each bank has a share of the profits, then each bank's incentive to maintain a good reputation in this cooperation makes them tacitly collude in punishing a country in default.

Literally speaking, there is no default along the equilibrium path in these models. Our repayment indicator, however, is arrears, which we view as an "early warning" indicator of outright default in the near future. Creditors can then signal their willingness to exercise the exclusion punishment by raising prices in response to going into arrears. There is also a micro-finance literature that usually analyzes two types of borrowers, whose identities are their private information. For example, Eaton (1996) employs this approach for a sovereign debtor. The overall conclusion is that there are equilibria in which the defaulters pay more in interest or are denied loans.

The other channel is that past repayment problems are either simply a signal of a future default problem or will endogenously imply a higher default probability. For example, an approach to understand default costs is that governments repay their sovereign debt to affect agents' expectations about the fundamentals of the economy (Sandleris, 2004). One can use also a dynamic model of sovereign borrowing to examine optimal consumption and default strategies. The dynamic perspective allows the study of the effect of credit history, given the need to reenter the credit markets in the future. This approach is followed by, for example, Yue (2005), and Kovrijnykh and Szentes (2005).

Accounting for the two possible channels of influence is essential for understanding "reputation" as a repayment incentive. If past default increases the spread through a higher probability of future default, and hence, lowers the probability of repayment, then

the expected repayment is not altered. In this case, “reputation” cannot represent a repayment incentive. Only if past default would increase the spread on top of raising the probability of future default, would the expected repayment get higher and maintaining a “good reputation” would be a reasonable incentive to repay.

2.8 Major determinants of loan repayment and credit market development

Institutional arrangements per se do not always adequately warrant the enforcement of payment. That is, creditor’s rights are not completely protected. They could fail for many reasons: an inefficient judicial system, a bad policy of third-party collateral or guarantees, a lack of public dissemination of default data, etc. We can identify at least three large groups of potential factors, which determine loan repayments. The first one includes macroeconomic determinants. On the one hand, macroeconomic stability could be the reason for a low level of non-performing loans. On the other hand, credit rationing could explain the low level of overdue loans, since banks will lend money only to the high quality borrowers (Stiglitz and Weiss, 1981).

The second group of determinants is related to regulation and enforcement system. The main changes in the financial market regulation are among the key element to explain development of the credit market and the low level of arrears. If a country has a clear set of rules that protect creditor’s right combined with an efficient supervision of the rules then the creditors will have incentive to create some mechanism to ensure the repayment of a loan. If the rules of enforcement are inefficient, the cost of not paying a debt could be lower than the benefit. Among the inefficiencies we can mention a slow legal system and costly judicial proceedings.

The third set of variables is what we call private solutions to face the unwillingness to repay a loan. This group includes information sharing system, prescreening techniques, collection technology and private contracts. In many situations the financial system does not have the information on either the level of the debt or the history of the debtor and then the system is not in a position to limit the amount of loans. This is intensified by the lack of a good supervisory system within the financial sector (Edwards, 1995).

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2.9 Characteristics of credit markets in Africa

Credit markets in Africa have mainly been characterized by the inability to satisfy the existing demand for credit in rural areas. However, whereas for the informal sector the main reason for this inability is the small size of the resources it controls, for the formal sector it is not an inadequate lending base that is the reason (Aryeetey, 1996b). Rather, the reasons are difficulties in loan administration like screening and monitoring, high transaction costs, and the risk of default. Credit markets are characterized by information asymmetry, agency problems and poor contract enforcement mechanisms (Nissanke and Aryeetey, 1995). They are mainly fragmented because different segments serve clients with distinct characteristics. Because of this, lending units are unable to meet the needs of borrowers interested in certain types of credit. The result is a credit gap that captures those borrowers who cannot get what they want from the informal market, yet they cannot gain access to the formal sources. Enterprises that want to expand beyond the limits of self-finance but lack access to bank credit demand external finance, which the informal sector is unable to satisfy.

Two main theoretical paradigms have been advanced to explain the existence of this fragmentation: the policy-based explanation and the structural-institutional explanations (see Aryeetey et al., 1997). According to the policy-based explanation, fragmented credit markets (in which favoured borrowers obtain funds at subsidized interest rates, while others seek funds from expensive informal markets) develop due to repressive policies that raise the demand for funds. Unsatisfied demand for investible funds forces credit rationing using non interest rate criteria, while an informal market develops at uncontrolled interest rates. Removing these restrictive policies should therefore enable the formal sector to expand and thereby eliminate the need for informal finance. According to the structural-institutional explanations, imperfect information on creditworthiness, as well as cost of screening, monitoring and contract enforcement among lenders, results in market failure due to adverse selection and moral hazard, which undermines the operation of financial markets. As a result, lenders may resort to credit rationing in the face of excess demand, thus establishing equilibrium even in the absence of interest rate ceilings and direct allocations. Market segmentation then results. Market segments that are avoided by the formal institutions due to institutional and structural factors are served by informal agents who use personal relationships, social sanctions and collateral substitutes to ensure repayment. An extended view of this explanation is that structural barriers result in monopoly power, which perpetuates segmentation.

Another view has attempted to explain the existence of informal finance as simply residual finance, satisfying only the excess demand by those excluded from formal finance. According to this view, informal sector finance develops in response to the formal sector controls. Structural and institutional barriers across segments perpetuate segmentation by providing opportunity for monopoly power. A further explanation is that

fragmentation exists due to inherent operational characteristics of the markets. Looking at the role of informal financial sectors in Ghana, Aryeetey and Gockel (1991), attempted to investigate factors that motivate the private sector to conduct financial transactions in the informal financial sectors. They argue that the informal sector derives its dynamism from developments in the formal sector as well as from its own internal characteristics.

The informal and formal sectors offer similar products that are not entirely homogeneous, implying that both sectors cater to the needs of easily identifiable groups of individuals and businesses, but at the same time serve sections of the total demand for financial services. However, participants from either sector may cross to the other depending on factors like institutional barriers, availability of credit facilities and the ease of physical access. Aryeetey and Gockel (1991) examine some of the factors that influence demand for formal savings and lending facilities in Ghana and observe that incomes, bank formalities and banks' preference for large transactions were the major ones. Travel costs and time are among other factors that determine transaction costs to the entrepreneurs. Besley (1994) has classified major features of rural credit markets that can be used to explain the existence of formal and informal credit markets in Africa. Among these are the existence of collateral security and covariant risk. Collateral security is often beyond the reach of many borrowers in rural areas. But even where this is not the case, the ability of the lender to foreclose is often limited, making enforcement of loan repayment difficult. Such difficulties help to explain the use of informal financial markets, which use social sanctions to ensure enforcement. In rural areas, shocks in incomes that create borrowers' potential to default will affect the operation of credit markets. In most rural economies, borrowers are faced with risks arising from uncertainties about their incomes. By diversifying their loan portfolios, lenders can avert such risks. However, credit markets in rural areas are segmented, with lenders' loan portfolios being concentrated on

borrowers facing common shocks to their incomes. An important cost of segmentation is that funds fail to flow across groups of individuals despite the benefits of doing so. According to Besley (1994), this kind of segmentation may also be reinforced by government regulations. In incomplete markets, rural households could use partially functioning credit markets to provide insurance against income shocks mainly by trading insurance. However, due to incomplete information about the nature of the risk faced by each individual, and possible changes in the private behaviour of other individuals, insurance arrangements are only partial (Aryeetey, 1996b) or are totally absent (Aryeetey and Udry, 1997).

Another important factor of both formal and informal markets relates to penalties. In the absence of formal contract enforcement mechanisms, both formal and informal institutions rely on lending practices that emphasize loan screening rather than monitoring, which appears to suggest more concern with adverse selection than moral hazard. Differences emerge in the methods used by formal and informal institutions. Whereas formal lenders rely more on project screening, informal lenders rely more on the character and history of the borrower, particularly on personal knowledge of the borrower. Loan monitoring is rarely done by informal lenders due to the lenders' knowledge of borrowers, while in the formal market it is mainly due to lack of facilities. Transaction costs are generally lower in informal markets than in formal ones. One of the issues that emerge from this market structure is which financial institutions are accessible to the rural poor, and which factors determine their demand for credit from the different sources as determined by their participation decisions.

The foregoing literature review shows that financial markets in African countries are characterized by imperfect and costly information, risks, and market segmentation.

resulting in credit rationing. This is one of the underlying factors in the coexistence of both formal and informal credit markets serving the needs of the different segments of the market. On the other hand, policy-based and structural-institutional explanations attempt to explain the coexistence of both segments of the market as a result of policy and structural-institutional rigidities. This review provides a conceptual background for an empirical investigation of borrowers' participation in credit markets and access to different sources. Imperfect information emerges as an important explanation for credit rationing. This is because, due to information asymmetry, loan terms and conditions are used that affect the behaviour of borrowers. The literature also shows that the assumption that formal interest rates are the reason borrowers do not use formal credit is not correct. Rather, the unique characteristics of credit services explain segmentation in the credit market. In addition, lack of effective contract enforcement and the consequent default risk are also important in loan rationing. Among the questions that arise out of this scenario is that of an empirical explanation for the coexistence of both formal and informal credit sources based on the foregoing background. A related question is that of access to financial services from both sources. In a fragmented credit market, what explains borrowers' decision to borrow at all, and whether to borrow from either formal or informal segments?

CHAPTER THREE

METHODOLOGY AND ORGANISATIONAL PROFILE

3.0 Introduction

This chapter looks at the methodology and the organizational profile of GCSL. Under the methodology, population, sample size and sampling technique, data collection and data analysis were discussed. The organizational profile of GCSL was presented under the following headings; background of GCSL, profile of shareholding, the institutions, governance, management and operations and products and services.

3.1 Population

The population for the study includes all the loan customers of GCSL as well as the loan officers in GCSL. GCSL has total of about two thousand and two hundred and thirty loan customers and seven loan officers in her five branches with Bantama and New Tafo branches having two officers each.

3.2 Sample Size and Sampling Technique

Due to budgetary constraints as well as the virtual impracticability of soliciting information from the entire population, a sample was taken for the study. The simple random sampling technique was used to gather data from customers. The total sample of the study was 223 and all loan officers.

3.3 Data Collection

The study was based on both primary and secondary data sources in the forms of questionnaires and personal interviews of loan officers and loan customers. Monthly and annual reports on loans and corporate plan of GCSL were obtained for the study and analysis. The research was based on two categories of data collection. They are primary and secondary.

3.3.1 Primary data collection

These were based on personal interviews and questionnaires from managers and officers of the loans department of GCSL and their loans customers.

The questionnaire designed for officers targeted all the five (5) branches of GCSL in Kumasi. Every branch has a Loan Officer who report through his Branch Manager to the Senior Loans Manager at the Head Office. In this regard all the six (6) officials in charge of Loans and the senior loan manager completed the questionnaire stating varied opinions, ideas and challenges that arises from their loan operations at the branches. The Officers also offered expert recommendations to improve on loan processing and approval in the company.

Secondly, the researcher used a simple random sampling technique to gather data from the loan customers of GCSL.

The loans are classified into the following categories i.e. Corporate, Susu (Special, Prestige, Adepa), Boafo Yenna, Personal, Employee and Yemma Daakye Loans.

However, as loans to commerce takes about 90% of all loans, 200 loan customers of the various Susu products were randomly selected, focusing on 40 customers each from all the five branches of GCSL Limited.

Furthermore, a random selection of loan beneficiaries were made on the criteria below:

Corporate – [5] Personal - [5] Employee - [5] Yemma Daakye - [3] Boafo Yenna - [5].

It is worth noting that the random sampling of loan beneficiaries took into consideration the remaining business activities aside from commerce to ensure that the final results will be a true reflection of all the business areas on the market that enjoy loans from the company.

In terms of the spread of the loan customers, 98% are resident in Kumasi metropolis, with about 2% spread in the environs of Kumasi within a radius of 20kms. This made it imperative to concentrate the research activities within Kumasi where most of the customers are concentrated.

3.3.2 Secondary data source

Secondary sources such as GCSL management reports and loans contract terms, financial statement of customers, Bank of Ghana's (BOG) on-site and off-site reports, corporate plan of GCSL, Ghana Microfinance Institutions Network (Ghamfin) reports, Internet and other publications were used to gather information on MFIs on loans contract terms.

3.4 Data Analysis

The data was analyzed using the tool of Statistical Package for the Social Sciences (SPSS). Tables and graphs were used to represent the data analyzed.

3.5 Profile of Garden City Savings & Loans Limited

3.5.1 Background

Garden City Savings & Loans Ltd is a non-bank deposit-taking financial institution established in September, 1998 in Kumasi to engage in deposit mobilization and granting of credit. The company started operation in August, 1999 and currently recognized as one of the best non-bank privately owned financial institutions in the country which have satisfied the minimum capital requirement set by the Bank of Ghana. The company is owned by seventeen Ghanaians out of which four are on the Board of Directors which is responsible for the formulation of policies, and provides the general direction for the management of the company.

The Head office of the company is located at Bantama with branches at Adum, New Tafo, Tanoso and Suame all suburbs of Kumasi in the Ashanti Region. The location of the company and its branches offer an atmosphere which is consistent with its mission of serving people in its catchment area. The GCSL primarily offers three final products, namely deposit mobilization, consumer (personal) credit and micro enterprise credit. Consumer loans are mainly for employees or previously qualified individuals with stable source of income, while micro enterprise loans are for micro entrepreneurs and self employed professionals and artisans.

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3.5.2 Profile of Shareholding

GCSL is registered as a company limited by shares and as non-banking financial institution. The institution has seventeen (17) shareholders who are all individuals and Ghanaians. Out of ten million shares, only one million five hundred thousand shares has been issued as at December 31, 2008.

3.5.3 The Institutions Governance, Management and Operations

3.5.3.1 Organizational Structure

GCSL operates according to an organizational structure with well defined direct and clear vertical links between the different reporting levels and units with well specified, discrete functions, clear individual roles and accountabilities which are tied to the achievement of the corporate plan. The organizational structure of the company is flexible and could be adjusted to meet changing requirement.

3.5.3.2 Board of Directors

At the apex of the organizational structure of the company is the Board of Directors (BOD). The Board is the decision making body responsible for the formulation of policies and provides the overall strategic direction to the company to ensure that it maintains focus on its objectives and vision. The Board is also responsible for the appointment of key management staff of the company. It exercises supervision of the management through various sub-committees

(i) Administration, Audit and Finance Committee

(ii) Loans and Credit Committees

3.5.3.3 Management Team

The management team of the company comprises the Chief Executive Officer (CEO), the Head Banking Operations, the Senior Manager Loans & Credit, the Human Resource Manager, Marketing Manager, the Head, Systems Administration and the Head Internal Audit. The Management of the company has oversight responsibilities over the day-to-day administration of the company. Their function involves strategic decision making and planning that determine the goals of the business.

The decision on funds to be invested, how to invest the funds and the loans to be granted and management of assets and liabilities to avoid mismatches. The function of the team includes the following:-

- Identifying promptly, problems relating to the operation of the company and recommending possible solutions.
- Developing plans and strategies for consideration by the Board.
- Implementing policies and decisions of the Board;

- Approving loans and expenditure within the approved limits;
- Evaluating and appraising staff performance and making relevant recommendations for onward transmission to the Board.

3.5.4 Products and Services

3.5.4.1 Deposit Service

The main thrust of the company's business is the acceptance of micro deposits and provision of micro loans to economically active but poor individuals and groups in the society. As implied in its name, saving mobilization has been a very important integral part of the company's philosophy and strategy. Since most of the people tend to be savers rather than borrowers at any one time, the company has realized that providing better savings services is more effective in achieving an equitable distribution of financial services than providing cheap credit. It is the belief of the management of the company that the demand for loans could be largely financed through locally-mobilized savings. It is worthy of note that the emphasis on savings is not meant to keep surplus money away, but rather considered a desirable habit that must be acquired by the poor and sustained. GCSL has focused on voluntary savings; however, it believes that compulsory savings and voluntary savings are incompatible. The deposit services which primarily differ in terms of liquidity and return include:

- Regular Savings Deposits
- Time/Fixed Deposits
- Susu Savings Deposits and
- Group Savings Deposits

The company realized the need to provide its savers with security, convenience, liquidity and return. In this regard, it is always conscious of ensuring the following:-

- Maintaining a good reputation;
- Providing physical proximity easy access and little waiting time, as well as fast service delivery to its customers to reduce the cost and time needed for making deposits and withdrawals;
- Offering product mix to provide different types of liquidity or ease of withdrawals to cater for different liquidity preferences; and
- Setting interest rates at appropriate levels to ensure positive real return.

In addition to savings deposits, the company provides demand deposit (Current Account) service. On the credit side GCSL offers various products which address the needs of certain target groups like micro, small and medium entrepreneurs, co-operatives, solidarity groups, market vendors and salaried employees.

3.5.4.2 Characteristics of Deposits

3.5.4.2.1 Savings Deposits

Traditionally, savings deposits earn interest and have limited withdrawal periods and therefore should not be operated as current account. GCSL operates a passbook system which allows all payment and withdrawal transactions to be entered in the book. A customer needs a minimum amount of GH¢5 to open a regular savings account. However, only accounts with balances of at least GH¢20 earn interest. The interest rate on regular savings is 6% per annum, calculated monthly and credited to the accounts.

3.5.4.2.2 Time/Fixed Deposit Account

Interest rates on time/fixed deposit accounts are higher than those on the regular savings accounts. These rates are competitive and fixed based on Treasury bill rates. Currently, interest rates on fixed deposits range from 8% to 10% per annum.

3.5.4.2.3 Susu Savings Accounts

The company launched a susu-savings scheme in 1999 by organizing traders and other customers mainly in the informal sector to enable them make regular daily savings in the company and qualify for loan facilities. Minimum daily contributions are collected by agents of the company. All contributors are issued with passbooks into which all contributions and withdrawals are recorded.

3.5.4.3 Short-Term Lending Services

The company offers credit services, oriented primarily to the microfinance market. Loan sizes are mostly smaller and terms are shorter than traditional credit services due to its orientation to a target market. Credit is structured to require limited or no collateral in most cases using deposit as collateral.

Credit operations focus on both individual and group lending which include education.

The short term lending services of the company include the following loans:-

- Emergency loans – loans requiring prompt attention.
- Special purpose loans – loans for financing LPOs, supplies, contract works, general merchandise etc.
- Working capital loans – provision of additional funds

- **Business loans** – loans for traveling businessmen/women.
- **Import/export finance loans** – these are meant to cover payment of duties, freight charges, port charges etc; designed for importers and exporters.
- **Yennmma Daakye** – education assistance for parent and guardians.
- **Rent assistance** – means for the payment of rent advances mainly for salaries workers.
- **Group Guarantee Loans** – additional working capital loans designed for business groups and self help groups.

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3.5.4.4 Characteristics of Credit Delivery Services

3.5.4.4.1 Overdraft Facility

Some of the current account holders of the company are given overdraft facilities on request. The facility enables the account holder to withdraw amounts over and above the balance in the account to a level approved by the company. Amounts granted are payable over a specified period, usually within 6 months. Credible customers are usually granted repeat facilities. This facility is however, limited to very few customers since the company's emphasis is more on savings.

3.5.4.4.2 Loan Facility

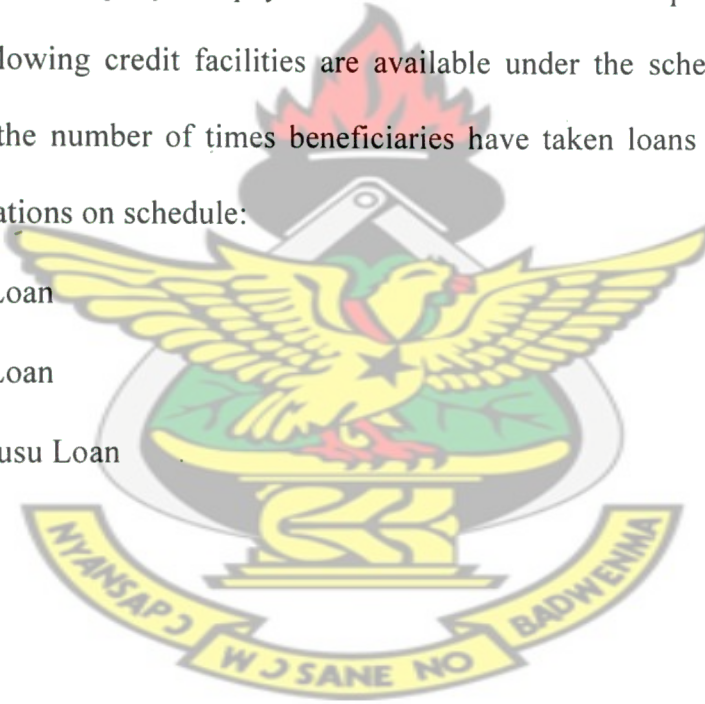
The company mainly offers consumer and micro enterprise credits. Consumer loans are for salaried workers and individuals with stable source of income. Micro enterprise loans on the other hand are for entrepreneurs and self-employed professionals who are customers of the company. The credit process that the company uses varies slightly from that used in the traditional banks, in terms of requirements, customer service, application form and contract. In addition, the organization of human resources, credit application,

evaluation and the authority for loan approval have been modified and simplified to suit the operation in the micro finance sector. The purpose of the reforms is to improve the quality and speed of customer service while allowing the company to improve on personnel efficiency and productivity and maintain portfolio growth and quality.

3.5.4.4.3 Susu Loans Scheme

Holders of susu savings accounts with the company are permitted to withdraw from their savings. The amount in the account could also serve to avail a customer a loan using a factor announced by the company. Repayment of loans should be completed within six (6) months. The following credit facilities are available under the scheme for repeat loans, depending on the number of times beneficiaries have taken loans and honoured their repayment obligations on schedule:

- Special Susu Loan
- Golden Susu Loan
- Golden Plus Susu Loan



CHAPTER FOUR

DATA PRESENTATION, INTERPRETATION AND ANALYSIS

4.0 Introduction

This chapter focuses on the presentation, interpretation and analysis of the data collected from respondents who were sampled for the purpose of the study. Simple random sampling was used to select two hundred and twenty three loan customers from GCSL premises and all the seven loan officers answered the questionnaire.

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4.1 Demographic Information of Respondents

Table 4.1.1

Sex and Age of Respondents

		age of respondent				Total
		18-25yrs	26-35yrs	36-50yrs	50yrs and above	
sex of respondent	Male	0	69	28	4	101
	Female	5	51	49	17	122
Total		5	120	77	21	223

Source: Field Study, July, 2009

Site: GCSL premises

Table 4.1.1 reveals that the proportion of females was relatively higher than the number of males who apply for loans at GCSL. There were 122 females and 101 males. The implication of the difference in numbers is most likely that women borrow more than men when it comes to microfinance activities. Most of the respondents who answered the questionnaire fell within the age range of 26-35 and this represents 53.81% of total

respondents and this was followed by the age range 36 – 50 which represents 34.52%. This is most likely to mean that most people within these age range forms the working class.

Table 4.1.2

Satisfactory Steps to qualify for a loan

		are the steps enough		Total
		yes, because it gives information about customer	no, because steps do not meet current needs	
steps to qualify for a loan	meet requirement for the specific loan	5	2	7
Total		5	2	7

Source: Field Study, July, 2009
Site: GCSL premises

Table 4.1.2 looks at the steps that qualify a person for a loan and the question was asked whether the steps were enough for GCSL to satisfy herself before loans are granted. For there are different requirement for specific loans and one has to meet these requirement before a loan can be given. All the 7 officers made mention of these steps however 2 of them said the steps were not enough whiles the remaining 5 said yes the steps were enough because they give all information required from the loan customers. The 2 who said no gave their reason as that these steps were not enough to all the information needed.

Table 4.1.3

Form of Business and Products Sold by Respondents

		Type of product						Total
		body & hair products	household consumables	agric	Clothing	building & hardware materials	no answer	
Form of business	of Commerce	36	50	4	103	7	0	200
	Construction	0	0	0	0	0	4	4
	manufacturing	0	0	0	0	0	6	6
	Others	0	0	0	0	0	13	13
Total		36	50	4	103	7	23	223

Source: Field Study, July, 2009
Site: GCSL premises

From table 4.1.3, 4 respondents out of the 223 were into construction, 6 were into manufacturing 13 engaged in other business and 200 respondents (89.68%) were into commerce of which 103 sell clothing, 50 sell household consumables, 36 sell body and hair products, 7 were into building and hardware materials and the remaining 4 were into agriculture. Most of the respondents who apply for loans from the institution are petty traders. This implies that GCSL as an MFI provides micro credit to low income clients.

Table 4.1.3

Form of Business and Products Sold by Respondents

		Type of product						Total
		body & hair products	household consumables	agric	Clothing	building & hardware materials	no answer	
Form of business	of Commerce	36	50	4	103	7	0	200
	Construction	0	0	0	0	0	4	4
	manufacturing	0	0	0	0	0	6	6
	Others	0	0	0	0	0	13	13
Total		36	50	4	103	7	23	223

Source: Field Study, July, 2009

Site: GCSL premises

From table 4.1.3, 4 respondents out of the 223 were into construction, 6 were into manufacturing 13 engaged in other business and 200 respondents (89.68%) were into commerce of which 103 sell clothing, 50 sell household consumables, 36 sell body and hair products, 7 were into building and hardware materials and the remaining 4 were into agriculture. Most of the respondents who apply for loans from the institution are petty traders. This implies that GCSL as an MFI provides micro credit to low income clients.

4.2

The Ability of Loan Applicants to Provide Needed Collateral

Table 4.2.1

Respondents who provided Collaterals

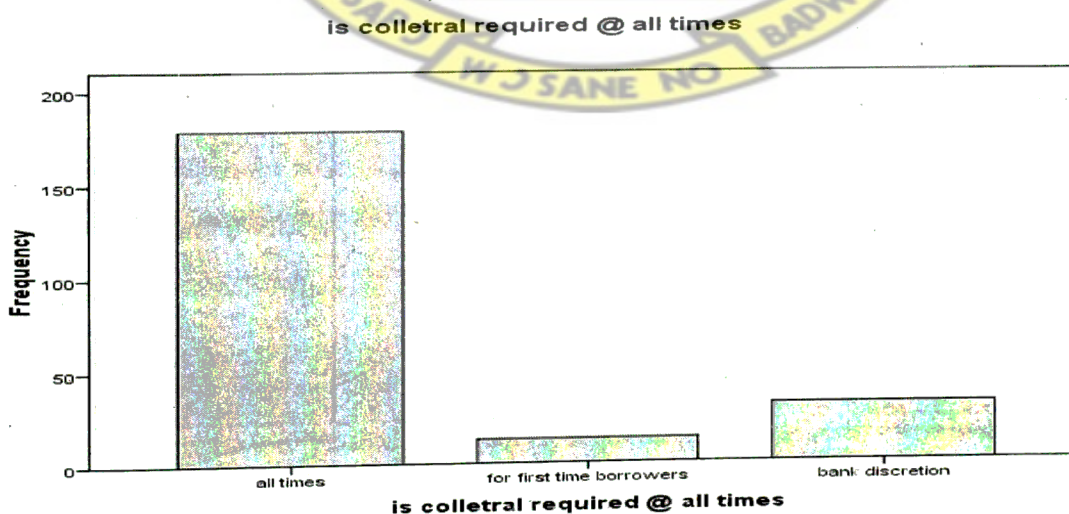
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Yes	223	100.0	100.0	100.0

Table 4.2.2

Forms of Collateral provided by Respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid landed property	14	6.3	6.3	6.3
stock reassignment	25	11.2	11.2	17.5
personal saving/lien	137	61.4	61.4	78.9
personal guarantee	28	12.6	12.6	91.5
all the above	19	8.5	8.5	100.0
Total	223	100.0	100.0	

Fig. 4.2



Source: Field Study, July, 2009
Site: GCSL premises

All respondents, 223(100%), were positive when asked if they were able to provide collaterals for their loans. This is represented in Table 4.2.1. The forms of collaterals provided however changed. Table 4.2.2 shows that relatively, a high percentage of the respondents, 61.4% (137 out of the 223) respondents provided personal savings/lien as collateral, 11.2 % (25 out of the 223) gave stock reassignment, 12.6% (28 out of 223) used personal guarantee, 6.3% (14 out of 223) provided landed property while the remaining 8.5% (19 out of 223) could provide all the above. Based on the differences in the forms of collateral provided, respondents views were sought if collateral should be a requisition at all times for a loan. Fig.4.2 reveals that a great number of the respondents 179 (80.3) agreed that collateral should be a requirement for loan acquisition. 13 respondents felt it should be a requirement for first time borrowers. 31 respondents however think that decision should be left to the discretion of the bank.

According to Financial institutions (Non-Banking) Law, 1993 on Legal and Regulatory Framework for Microfinance, "licensed banks should obtain physical assets to secure loans. However, formal sector banks and financial institutions have begun to accept treasury bills and deposit balances as acceptable collaterals. Close coordination between the Ministry of Finance, BOG and GHAMFIN have led to a better understanding of the characteristics of microfinance loans and, possibly, formalizing the status of group guarantees as acceptable collateral in microfinance loans." This statement is in agreement with the above analysis. Most of the respondents were small and medium scale enterprises which microfinance encompasses hence personal savings or deposit balances dominated as a form of collateral security other than physical assets.

The general impression is that most loan applicants are able to provide the needed collateral mostly in the form of personal saving.

4.3 The Creditworthiness of Loan Applicants

Table 4.3.1

Are Loan Customers Creditworthy

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Yes	7	100.0	100.0	100.0

Table 4.3.2

Basis for Accessing creditworthiness of Loan Customers

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Past records	1	14.3	14.3	14.3
1 & 2 above	4	57.1	57.1	71.4
1,2 & 3 above	2	28.6	28.6	100.0
Total	7	100.0	100.0	

Source: Field Study, July, 2009

Site: GCSL premises

Loan officers were asked on the creditworthiness of their loan applicants. All of the 7 officers affirm that their loan applicants were creditworthy as seen from table 4.3.1. On accessing their basis for customers' creditworthiness however, they gave different views on how creditworthiness was measured. Options given were: 1. Past records of applicants, 2. Account operation of applicant, 3. Reputation of applicant. Out of the 7 respondents, 1 officer used past records only, 4 selected 1&2 and 2 used all the above as basis for accessing creditworthiness of customers. This implies that a higher percentage (57.1%) of loan officers accessed their loan customers based on the past records, credit reference and the account operations of their customers. When the officers were asked if they can get credit reference, 5 of them responded yes by contacting the old and other

banks and the other 2 said no because most banks are not ready to give out information. This is illustrated in table 4.3.2 above.

Eaton and Gersovitz pioneered that “pure reputation” and past records are channels through which creditworthiness of loan customers could be accessed. The study however differs from this view. Most loan officers are of the view that to access creditworthiness of customers, their past records both with the bank and other banks, as well as their account operations are preferred channels to use especially for low income earners.

It can be observed from the study that most loan applicants are creditworthy when past records and account operations are used as basis for creditworthiness.



4.4 GCSL Capacity to Meet Loan Request of Her Customers

Table 4.4.1

Source of Funds to meet loan demands

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	customer's deposits	3	42.9	42.9	42.9
	2 and 3 above	1	14.3	14.3	57.1
	1,2 and 3 above	3	42.9	42.9	100.0
	Total	7	100.0	100.0	

Fig 4.4

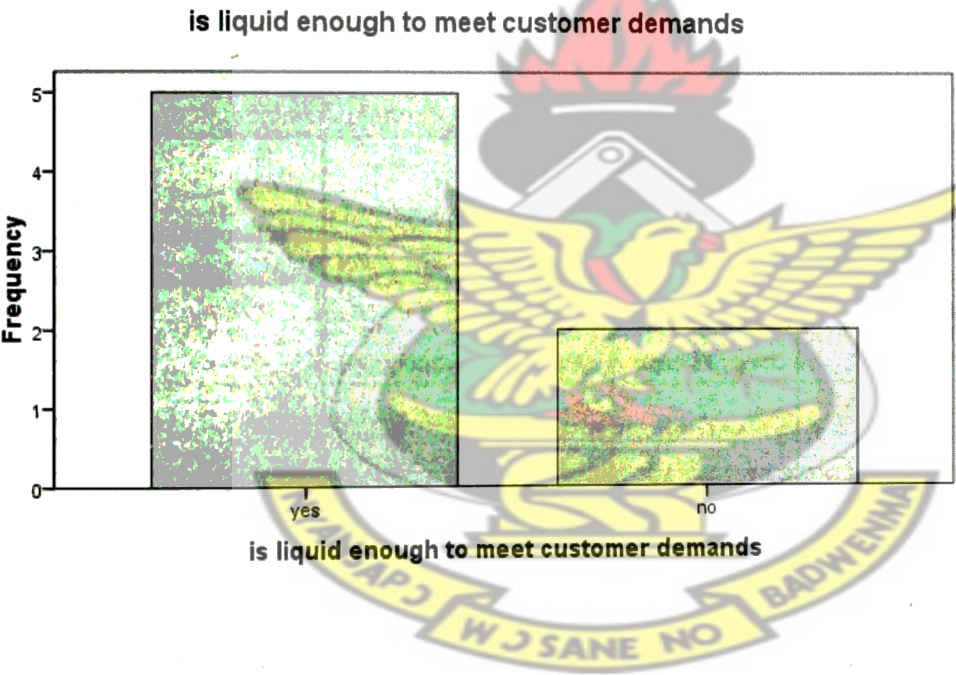


Table 4.4.2

Does bank meet primary reserve ratio each week

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	7	100.0	100.0	100.0

Table 4.4.1 depicts the sources of funds to meet customers' demands. Three options were given that is "bank borrowings, shareholders equity and customers' deposits. 3 (42.90%) out of 7 loan officers said all three were sources of mobilizing funds for the bank. Another 3 also said customers' deposits was the source of mobilizing funds for GCSL and 1 respondent said shareholder equity and customers' deposit.

Loan officers were further asked if these sources were enough to meet loan request of customers. From fig.4.4, Out of the 7 loan officers 5 representing 71.4% were of the view that GCSL was liquid enough to meet customers' demands while 2 of them representing 28.6% said GCSL was not liquid enough. However, all of them (7) said that GCSL was able to meet the primary reserve ratio requirement of Bank of Ghana which is 10% as seen from table 4.4.2

Table 4.4.3

Were you given the amount requested				
		Frequency	Percent	Valid Percent
Valid	Yes	161	72.2	72.2
	No	62	27.8	27.8
	Total	223	100.0	100.0
				Cumulative Percent
				72.2
				100.0

Source: Field Study, July, 2009
Site: GCSL premises

Not only were bank officers asked, but loan customers (223) were also asked if the banks were able to meet their request. Relatively, higher percentage of respondents, 72.2% affirmed the bank's capacity while 27.8% felt the bank was not able to meet their request. The question is, for those whose requests were not met, could it be that they were not able to meet the needed collateral?

The general impression is that to a large extent GCSL is able to meet loan request of customers.

4.5 **Loan Customers' Commitment to Follow Through Their Business Plan**

Fig. 4.5

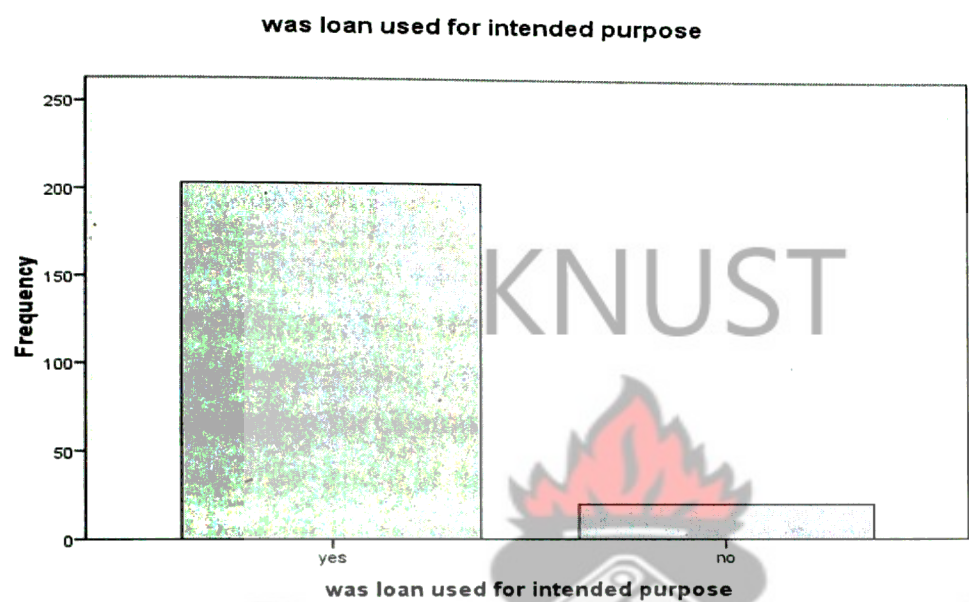


Table 4.5.1

Was loan used for intended purpose * if no what were the reasons

		if no what were the reasons			Total
		unforeseen events	the loan was inadequate	no reason	
was loan used for intended purpose	Yes	0	0	0	0
	No	4	16	0	20
Total		4	16	0	20

Table 4.5.2

How does business plan relates loan request				
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid it gives u an idea of the cash flow	4	57.1	57.1	57.1
it gives u an idea of the assets	2	28.6	28.6	85.7
Others	1	14.3	14.3	100.0
Total	7	100.0	100.0	

Source: Field Study, July, 2009
Site: GCSL premise

Fig.4.5 depicts whether the loan was used for the intended purpose. Out of 223 respondents 20 said “no” and 4 of the 20 assigned unforeseen events as the reason why the loan was not used for the intended purpose. 16 said the loan was inadequate to meet their needs and hence they have to use it for another purpose.

A higher number of the respondents (203) however, had their business plan relating to the loan request. This means that for most of the loans customers, the requested loan was used to accomplish the intended purpose.

Loan officers in accessing how customers are committed to follow through their business plan explained that to large extent business plan relates loan request. 4 out of 7 officers explained that it gives them an idea of cash flow of the applicant’s business. 2 of the officers said it gives an idea about the customer’s assets and 1 officer said others.

This implies that most respondents were able to use the loan for intended purpose.

4.6 Economic Indices Affecting Credit Management

Table 4.6.1

Is the economy conducive for credit administration

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid yes, because macroeconomic stability	5	71.4	71.4	71.4
no, because of high inflation rate and prime rate	2	28.6	28.6	100.0
Total	7	100.0	100.0	

Source: Field Study, July, 2009
Site: GCSL premise

From table 4.6.1, Loan officers were asked if the economy was conducive enough for credit administration. 5 responded “yes” because of the stable macro economy. 2 said “no” because of the increased prime rate and also the increasing trend of the inflation rate.

The country has experienced macroeconomic stability for the past five years and the government has acknowledged the fact that the private sector is the engine of growth.

According to Stiglitz and Weiss, 1981, “we can identify at least three large groups of potential factors which determine loan repayments. The first one includes macroeconomic determinants. On the one hand, macroeconomic stability could be the reason for a low level of non-performing loans.” This confirms the assertion by most of officers that macroeconomic stability of the country makes the economy conducive for credit administration.

It can therefore be deduced that macroeconomic stability of the country makes the economy conducive for credit administration. High inflation and prime rate rather affects credit management.

4.7 Challenges for Credit Administration

Table 4.7

Challenges faced managing credit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	lack of funds	2	28.6	28.6	28.6
	problem of repayment & no van for follow up	1	14.3	14.3	42.9
	inaccurate customer information	2	28.6	28.6	71.4
	all the above	2	28.6	28.6	100.0
	Total	7	100.0	100.0	

Other challenges faced by loan officers were also sought. From table 4.7, out of 7 loan officers, 2 of them said lack of funds has been a major challenge for the administration of credit, 1 officer said the major challenge is the repayment habit of some customers and unavailability of vehicle to follow up, another 2 said that inaccurate customer information is a challenge and the remaining 2 said all the four above are challenges they are faced with.

The ability to provide liquidity is a special function of banks (see Rajan (1996), Diamond and Rajan (1999), and Kashyap et al. (2000)). In providing liquidity services, banks are exposed to liquidity risk from unexpected withdrawals of deposits or unexpected take-downs of loan commitment facilities. This statement is in line with some of the reasons given above.

4.8 Recommendations to Improve Upon Loan Contract Terms

Table 4.8.1

Would you recommend loan based on trust and long term relationship

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	5	71.4	71.4	71.4
	No	2	28.6	28.6	100.0
	Total	7	100.0	100.0	

Table 4.8.2

Loan officers' suggestions to improve loan contracts

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	regular meetings with customers	1	14.3	14.3	14.3
	Insurance	1	14.3	14.3	28.6
	all the above	5	71.4	71.4	100.0
	Total	7	100.0	100.0	

From table 4.8.1, 5 of the officers recommended that loans should be granted based on trust and long term customer relationship and 2 of them said no.

Table 4.8.2 looks at the suggested ways to improve loan contract term at GCSL by loan officers. These suggestions are, there should be regular meetings with customers and GCSL should insure all loans that will be given out. 5 of them were of the view that all the reasons above should be implemented to improve credit administration, 1 said regular meeting with customers will improve credit administration and 1 said all loans granted need to be insured.

Fig.4.8

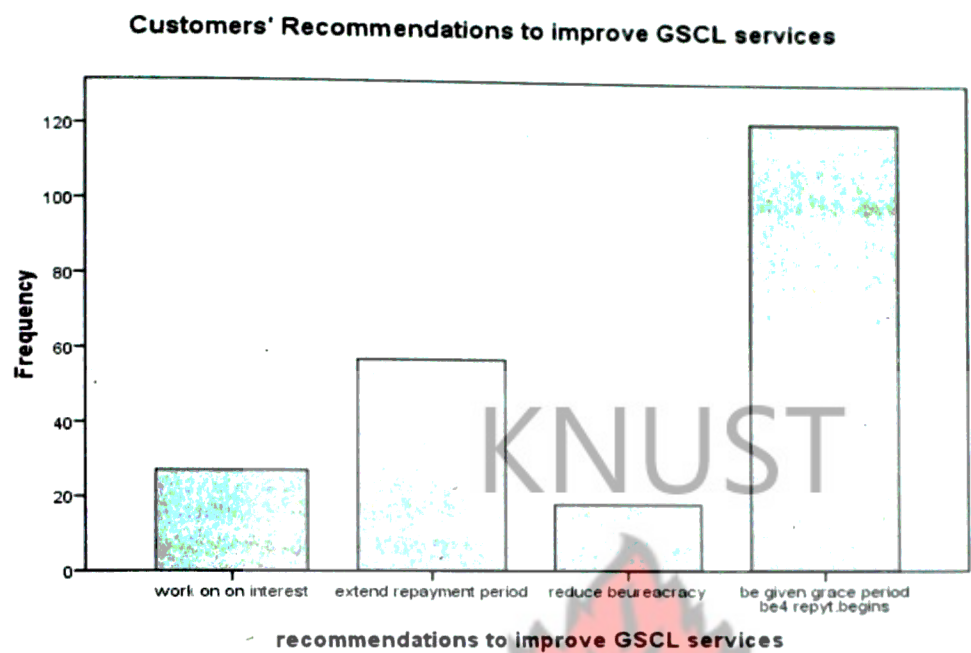


Fig.4.8 looks at customers recommendations to improve loan services. 121 of the respondents said GCSL should give grace period before repayment begins , 58 of them said their repayment period should be extended,27 of them said GCSL should reduce the bureaucracy in granting loans and 17 said the interest was on the high side. This implies that GCSL starts the deduction of her loans in the same period the loans are given and also have a high interest rate.

In conclusion, the application of the SPSS for this analysis has given objective outcomes from the sampled population. The objectivity of the analysis validates many of the assumptions from the study objectives as well as providing new insight into loan contract terms which must be critically addressed to improve loan administration at GCSL. Additionally the graphical data generated by the analysis gives a pictorial view of the relationships making it more meaningful and educative as a study case of GCSL.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter takes a general look at the whole work. It entails three sections namely; findings, recommendation and conclusion of the entire work. The findings were derived from the presentation and analysis of data gathered from the field. In addition the researcher also proposed certain recommendations that will improve loan contract terms at GCSL.

5.1 Findings

- Most of the respondents who answered the questionnaire fell within the age range of 26-35 and this represents 53.81% of total respondents and this was followed by the age range 36 – 50 which represents 34.52%. This is most likely to mean that most people within these age range form the working class and are economically active. This group is at the prime age and would like to take challenges for a secured future.
- Most of the respondents who apply for loans from the institution are petty traders. This implies that GCSL as an MFI provides micro credit to low income clients.
- A greater number of the respondents that is 137 representing 61.4% said personal savings was used as collateral and this creates general impression that most loan applicants are able to provide the needed collateral mostly in the form of personal saving. A saving culture will eventually ensure economic development for the country.
- It was observed from the study that most loan applicants are creditworthy when past records and account operations are used as basis for creditworthiness.

- It was also observed that 72.2% of loan customers and 71.4% of the loan officers affirmed GCSL capacity to meet customers' request and this creates general impression that to a large extent GCSL is able to meet loan request of customers.
- A higher number of the respondents (203) said the requested loan was used to accomplish the intended purpose
- It was deduced from the study that macroeconomic stability of the country makes the economy conducive for credit administration. High inflation and prime rate rather affects credit management.
- It was also observed that lack of loanable funds was a challenge to GCSL
- A higher number of the loan customers (121) said that GCSL should give them grace period before repayment of the principal starts.

5.2 Conclusion

Until recently, poor persons applying for micro loans in order to improve their self-employment opportunities were mostly excluded from the credit market. As a consequence, they were either unable to be self-employed, or, if they had started their own business, suffered from under-financing and were not able to expand their business. On a macro-level, the lack of financial capital for small and micro businesses has been a major obstacle to the small-scale private sector not only in developing, but also in transition and, to a smaller extent, in industrialized economies.

The reasons of exclusion contain a risk and a cost component:

- 1) All persons without collateral are unable to signal their creditworthiness so that banks which secure loans by collateral are incapable to assess their risk.
- 2) Given that persons running a micro-business mostly ask for small loan sizes, it is not feasible in the usual banking system to substitute the additional screening and monitoring

efforts for collateral. The added cost then surpasses the potential revenues and, thus, most institutional lenders using conventional financial technologies consider the disbursement of micro credits highly inefficient. During the last three decades, major progress in this sector has been made. The proponents of the so-called micro-finance paradigm showed that the problems can be addressed by creating and implementing new micro-lending technologies. These proved to work quite efficiently in many countries, by giving access to credit to those persons who became able to signal their creditworthiness at lower cost due to the new technology. The main progress of the Micro Finance Institutions (MFIs) is that they have developed mechanisms where borrowers form groups which jointly share liability for loan delinquencies or default. The incentives set by such contracts enable the lender to reduce his cost of screening, monitoring and enforcement. In view of this, the loans department of GCSL should constantly beef up the procedural requirements to avoid any loan defaults.

Also, with 61.40% of respondents providing personal savings as collateral is a positive sign for GCSL as an MFI and it is part of her objective to inculcate a savings culture into her customers. Once customers are able to save and use it as collateral will support the developmental goals of the Ghanaian economy.

However the loan officer must ensure that their appraisals identify the level of loan that can be offered in order not for customers to misapply the loan as against their business plan proposals.

The positive liquidity situation of the company gives credence to the fact that there are good management practices and a strict adherence to her credit policy. Obviously, the minority who are denied loans do not fully meet the entire loan requirements.

5.3 Recommendations

- GCSL should improve upon the steps that qualify customers for loans and also grant loans to non customers. With the licensing of more banks and savings and loans companies, competition in the banking sector has been keen. Most of the universal banks are now into the micro finance activities and this calls for improvement in granting loans and ways of doing things. GCSL should also ensure that enough information is gathered on applicants and their guarantors before loans are given out.
- GCSL should intensify her monitoring activities. More time is spent on screening new applicant than on monitoring activities. Repayment can be effective if there is constant monitoring of the loan.
- GCSL should take advantage of the credit reference bureau established recently to check the creditworthiness of her customers.
- GCSL should insure her loans at the cost of her customer in order to reduce losses. Most low income earners do believe that loans granted to them are government funds and hence feel reluctant to pay when due. It will help solve this problem if an insurance policy is taking at the expense of the loan customers.
- A policy document on mobilization of funds can be adopted by GCSL in order to increase her mobilization drive in order to meet the demands of her customers. Many of the SMEs lack the necessary capital to expand their business and they fall on MFIs to access credit. These MFIs can only grant loans when they have

more than enough funds to meet depositors' unexpected withdrawals. And more loans can be granted if MFIs have excesses and hence policy on deposit taking is necessary.

- Regular training programmes should be organized for the loan officers in order to be abreast with the current way of appraising loans. All most all the loan officers gave different views on certain basic things that were asked which demanded the same response from all of them since they belong to the same company. There should be a standard way of doing things.
- Customers should be educated as to why his or her loan request was not met or why his or her loan request was delayed. Educational programmes should also be organized for most customers to educate them on the dos and don'ts, what the requirements are to qualify for a facility. This will go a long way to reduce the default rate of loans and also reduce cost of administering credit at GCSL.
- GCSL should strengthen her loan recovery department by equipping them with vehicles to follow up on customers who default in repayment. Monitoring of loans starts when the loan is giving out and there has to be a constant monitoring of these loans as and when customers default, and this can be done effectively if only there is a standby vehicle to do these follow up exercises.
- GCSL should improve on her intake of customers' information. Most of the data on customers are inaccurate especially the susu customers and this makes the

appraisal of susu loans very difficult. Steps should be put in place to improve upon information intake.

- GCSL should give her customers grace period to turnaround monies given to them before repayment starts.
- GCSL should increase her profitability drive in order to grow and be able to attract more external finance. It is therefore necessary to provide a policy environment that affords the necessary incentives for the company's growth.



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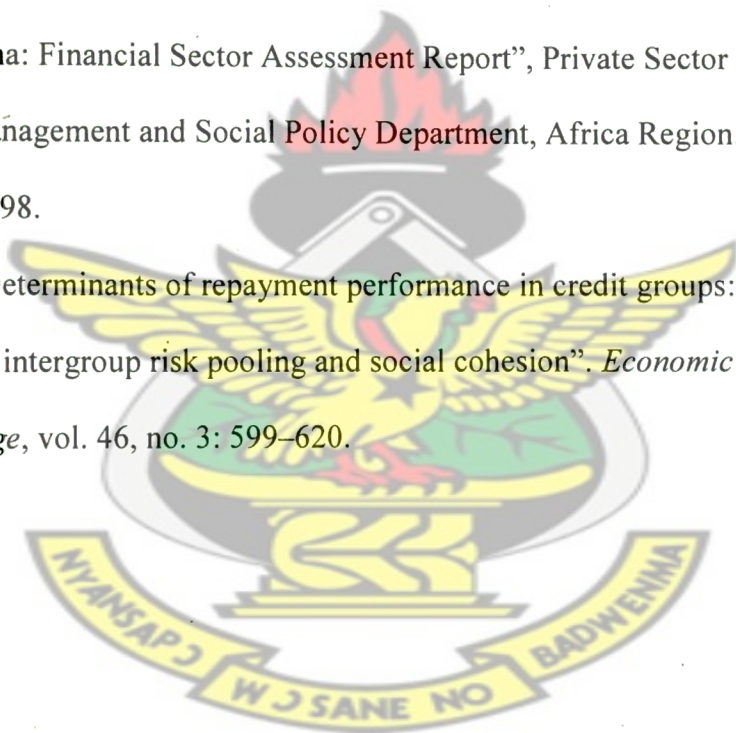
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SAMPLE QUESTIONAIRRE

KWAME NKRUMAH UNIVERSITY OF SCIENCE & TECHNOLOGY LOANS CUSTOMERS

1. Sex

(a)Male

(b) Female

2. How old are you?

(a)18-25years (b)26-35 years (c)36-50 years (d)50-65years (e)above
65years.

3. What form of business are you engaged in?

(a)Commerce (b) Construction (Road/Building/Quarry) (c) Manufacturing
(d) Agric (e) Others (specify).....

4. If you are into commerce, specify the type of products you apply the loan for.

(a)Body & Hair products (b) Household consumables (c) Agric
(d)Clothing (d) Building & hardware materials (e) Other
(specify).....

5. Were you required to provide any form of collateral to enable you secure a loan?

(a)Yes

(b) No.

6. If yes, which of the following forms of collateral security did you provide for the
loan?

(a)landed property (b)stock reassignment (c)personal savings/lien
(d)personal guarantee (e)other specify.....

7. If no, why were you not able to provide the collateral security?

.....
.....
.....

8. As a customer, is collateral a requirement at all times for a loan?

(a)All times (b) For only first time borrowers (c) Bank discretion (d)
Other specify.....

9. How long have you being saving with Garden City Savings and Loans Limited?

(a) Less than one year (b) One year (c) Two years. (d) Three years. (e) More than three years.

10. Do you enjoy GCSL services?

- a. (a)Yes (b) No

11. If yes, what type of service?

.....
.....
.....

12. How many times have you borrowed from GCSL

- a. (a)once (b) two times (c)three times (d)four times (e)more than four times

13. Were you given the amount requested?

- a. (a)Yes (b) No

14. If No, what were the reasons for the reduction?

.....
.....
.....

15. Was the loan given to you on time?

- (a)Yes (b) No

16. If No, what were the reasons for the delay?

.....

17. Were you able to use the loan for the intended purposes?

- (a)Yes. (b)No

18. If no what were the reasons?

.....

19. What recommendations will you make to improve upon the services of GCSL?

.....
.....
.....
.....

QUESTIONNAIRE

KWAME NKRUMAH UNIVERSITY OF SCIENCE & TECHNOLOGY

LOANS OFFICERS

1. What are the steps that a customer has to go through before he/she qualifies for a loan?
.....
.....
2. Do you think these steps or requirements are enough?
a) Yes b) No
3. How long does it take you to grant a loan facility to your customer?
a. One day b) two days c) three days d) four days e) one week e) Other
(specify)
4. Are your loan customers creditworthy?
(a)Yes (b) no
5. If yes what basis did you use to access his/her credit worthiness?
.....
.....
.....
6. Do customers provide collateral security?
(a) Yes (b) No
7. Are the collateral provided by customers enough to secure the loan.
(a)Yes (b) No.
8. What type of collateral do you accept from customers?
(a) Landed property (b) stock assignment (c) personal guarantee (d)
savings/liens.
9. What are the challenges you face when managing credit.
.....
.....
.....
.....
.....
10. Is the economic environment conducive for credit administration
(a)Yes (b) No

11. If yes give reasons.

.....
.....

12. If No give reasons.

.....
.....

13. Is GCSL liquid enough to meet customer demands?

(a)Yes

(b) No

14. If yes, is GCSL able to meet primary reserve ratio each week.

(a)Yes

(b) No

15. Would you recommend the giving of loans based on trust and long -term customer relationship?

(a)Yes

(b) No.

16. What are the sources of capital for GCSL to meet its loan demands by customers?

(a)Bank borrowing

(b) shareholder equity

(c) customer's deposits

17. Are you in the position to get credit reference on your loan customers?

(a) yes

(b) No

18. If yes how?

.....
.....

19. If no why?

.....
.....

20. To what extend does an applicant business plan relates to their loan request?

.....
.....

21. Suggest ways to improve loan contracts at GCSL.

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