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AN OVERVIEW OF LOAN PORTFOLIO AT RISK IN THE MICROFINANCE INDUSTRY SSA

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ABSTRACT
The study explore the levels of Loan Portfolio at Risk in the microfinance industry. Using trend analysis from 6 regional blocks (Sub Saharan Africa, East Asia and The Pacific, Eastern Europe and Central Asia, Latin America and The Caribbean, Middle East and North Africa and South Asia), our findings suggest that Sub Saharan Africa has the highest level of loan portfolio risk during the period of study. Again it was also observed that the Eastern Europe and Central Asia is the region with the least recorded loan portfolio risk in whole. Given the effect of Loan portfolio risk on performance of the microfinance industry, it is recommended that, a more rigorous study is done to assess factors that determine the effect of loan portfolio risk.

Introduction

The inclusion of poor entrepreneurs in formal financial system was not common, (Brau and Woller, 2004). Their inclusion was either in the form of partial inclusion in developed countries or full exclusion in less developed countries (Brau and Woller, 2004, Godquin, 2004). This inability of the formal financial system to address the financial constraints of the poor resulted in informal and community based financial services to address the financial desires of the poor (Rosenberg, 2005).

However, empirical studies (Ameen, 2004; Brau and Woller, 2004), projects the benefit of micro financing to poor entrepreneurs. Most researchers believe that, the introduction of microfinance in addressing the financial needs of poor entrepreneurs have led to an increase number of formal financial organizations, bringing banking servicing to the door steps of the less privilege (Ameen,, 2004; Brau and Woller, 2004; MIX and CGAP, 2008, 2010, 2011). Furthermore, micro financing has enhanced the economic development of the marginalized, as they are able to access education, healthcare, and techniques for agro–businesses which could foster their livelihood (Abdul and Bayu, 2012; Waweru & Gary 2012)).

The microfinance (MF) industry in Sub Saharan Africa (SSA) has taken advantage of the accelerated development in the sub region. This has positively impacted the development of the microfinance sector, more especially in the year 2007 when Microfinance institutions (MFIs) attain operational self-sufficiency through increase in outreach drives. Nonetheless the global financial crises had an adverse effect on the GDP growth of the region, (GDP growth dropped from 7 percent in 2007 to 5.5 percent in 2008, while inflation rose from 6.8 to 11.9 percent) (MIX and CGAP, 2008, 2010, 2011) affecting loan portfolio risk management in the MF industry. The 2008 global financial crises led to 6 percent dip in the loan portfolio risk performance of MF sector in SSA (MIX and CGAP, 2008). Likewise, MF industry within the SSA is faced with threats (Crabb, and Keller 2008). These challenges range from increase in operating expenses, falling in rate of returns. Also, portfolio quality is poor and has worsened over the years, coupled with weak supervision. The overall penetration rate is very slow, as most MFIs concentration is on specific sectors of the economy. In addition, the aggressive loan expansion derive embarked by MFIs in recent years has led to a deteriorating operational environment and the rising interest rate could lead to further vulnerabilities for their loan portfolio at risk management. With the diversity of experience in the MF industry within the SSA region, this study therefore, reviews loan portfolio risk trends from 2000 to 2012 by comparing SSA region with other regions.

Methodology

The overall objective of the paper was to examine the level of loan portfolio at risk in the Microfinance industry. Employing descriptive research approach the study adopted weighted average method and trend chart analysis to assess the level of Loan Portfolio at Risk in the microfinance industry. The study used 13 years (2000 to 2012) sampled data from Microfinance Information Exchange Market (Mix Market) on 6 regional blocks (Sub Saharan Africa, East Asia and The Pacific, Eastern Europe and Central Asia, Latin America and The Caribbean, Middle East and North Africa and South Asia) to examine the year on year level of loan portfolio at risk and region on region level of loan portfolio at risk for the period under study.

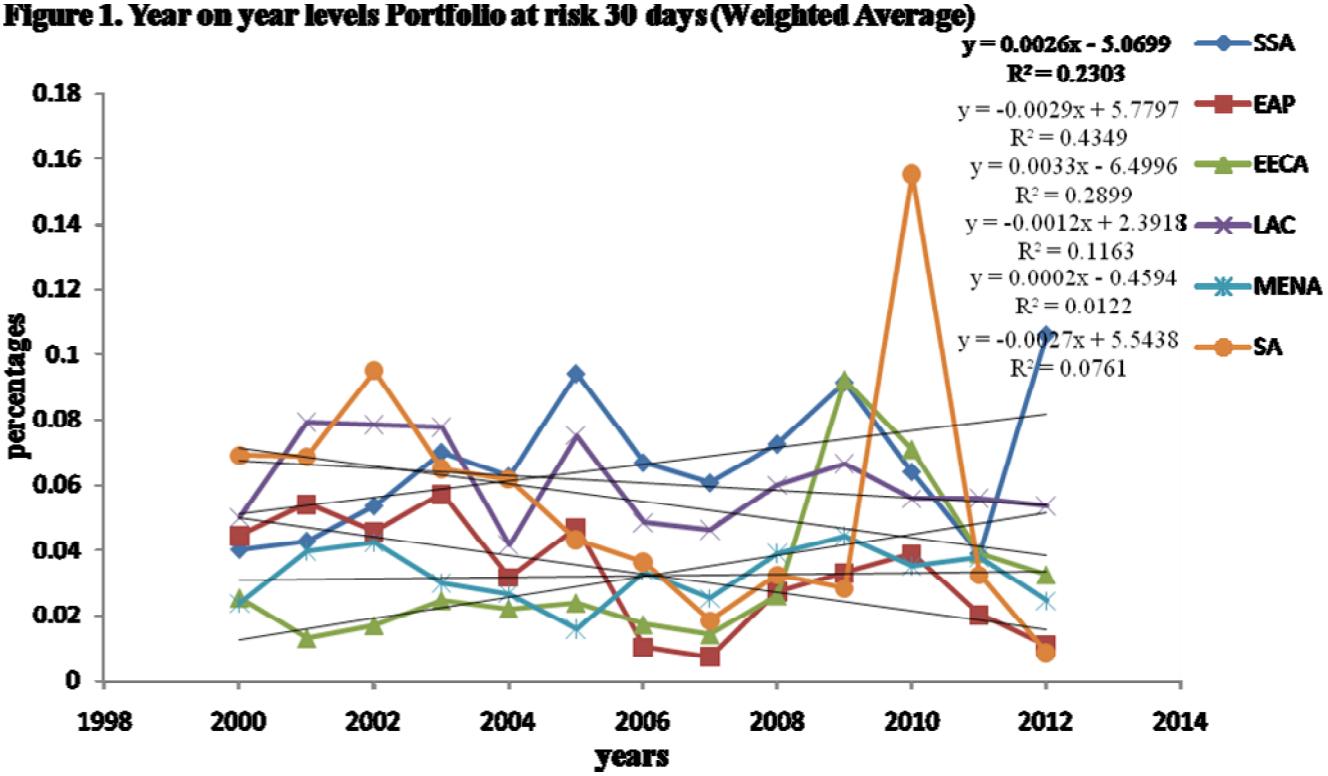
Results and Discussion

The level of loan portfolio at risk of MFIs classified into regions (SSA, East Asia and The Pacific, Eastern Europe and Central Asia, Latin America and The Caribbean, Middle East and North Africa and South Asia) was analysed over the 13 year period of the research work. Figure 1 and Table 1 shows the trend of loan portfolio at risk in the six regional classification of loan portfolio risk in the industry.

Year on Year Level of Loan Portfolio at Risk

Figure 1 show the year on year variation of loan portfolio at risk using the gradient of line. From the trend analysis there was a positive significant relationship between year (time) and loan portfolio at risk in SSA region and EECA region. The analysis indicates that MFIs in SSA and EECA face high exposures of debt on the financial statement with respect to time. This affects their capacity to increases lending therefore by reflecting negatively on the economy. However, LAC, EAP and SA show a negative relationship between time and loan portfolio at risk. This relationship suggests a sound, well capitalised and liquid microfinance sector of the three regions. MENA region recorded an insignificant positive growth in the loan portfolio by 0.0002 with respect to time. Whereas 2008 to 2010 was a challenging period for MFIs, as the industry recorded an increase in loan portfolio at risk due to the global credit crises. The limitation of this finding is that year (time) is the only variable used in the trend and level analysis.

Figure 1. Year on year levels Portfolio at risk 30 days (Weighted Average)



Source: Computations from Data obtained from the various databases (2015).

Regions on Region Level of Loan Portfolio at Risk

Table 1 Region on Region Level of Loan Portfolio at Risk

Years	SSA	EAP	EECA	LAC	MENA	SA
2000	4.03%	4.45%	2.52%	5.00%	2.36%	6.90%
2001	4.29%	5.41%	1.29%	7.92%	3.99%	6.87%
2002	5.35%	4.56%	1.68%	7.83%	4.24%	9.49%
2003	6.99%	5.72%	2.44%	7.76%	2.98%	6.49%
2004	6.26%	3.16%	2.19%	4.17%	2.66%	6.17%
2005	9.39%	4.69%	2.37%	7.51%	1.57%	4.33%
2006	6.68%	1.01%	1.70%	4.84%	3.35%	3.63%
2007	6.06%	0.72%	1.40%	4.63%	2.52%	1.82%
2008	7.24%	2.72%	2.59%	5.99%	3.91%	3.24%
2009	9.13%	3.30%	9.23%	6.65%	4.45%	2.81%
2010	6.40%	3.87%	7.09%	5.57%	3.52%	15.52%
2011	3.90%	2.00%	3.91%	5.58%	3.79%	3.24%
2012	10.58%	1.08%	3.24%	5.36%	2.44%	0.84%
Summation	86.30%	42.69%	41.65%	78.81%	41.78%	71.35%
Overall Weighted Average	7.19%	3.56%	3.47%	6.57%	3.48%	5.95%

Generally SSA consistently accounted for higher portion of loan portfolio at risk in the MF industry. From the table, SSA was the region that suffered the highest loan portfolio at risk. In the year 2004 to 2012, MFIs in SSA region was highly affected by loan portfolio risk problems. Although, SSA experienced the highest loan portfolio risk problem within the period of 2004 to 2007, the region had a drop in their loan portfolio risk by 0.62% from 2006 to 2007. This could be inferred to the fact that in 2007, MFIs in SSA enjoyed financial self-sufficiency. Furthermore, the region was highly affected by the global economic credit crises with a rate of 7.24% and 9.13% in the year 2008 and 2009 respectively. This massive impact of the credit crises on the MF industry of SSA could result from the fact that the MF industry of SSA is highly leveraged as compared to other regions whose activities are funded by donor investment. East Asia and the Pacific (EAP) region was the third least region to be affected by loan portfolio at risk. The region recorded an overall loan portfolio at risk of 42.69% and a weighted average of 0.0357 over the 13 year period of the study. Although the loan portfolio was slightly affected by the global economic crisis by an increment of 2.00%, it did not exceed the regional weighted average rate of 5.04%. The highest loan portfolio at risk recorded by the region was in the year 2003 (5.72%) and 2001 (5.41%).

Eastern Europe and Central Asia (EECA) region experience the lowest loan portfolio risk as compared to the other regions. EECA region recorded a rate of 1.25% to 3% from 2000 to 2008. This low loan portfolio risk enjoyed by EECA could be as a result of efficient and effective credit risk administration and management; such as, an appropriate investment mix, also paying off and tracking of high interest credit. Furthermore, rebalancing of portfolio occasionally could partly contribute to the low rate of PaR in the EECA region. Since it helps maintain the portfolio at a comfortable risk level. This was to avoid overemphasizing one or more asset categories. In spite of the high performance by EECA region, the region was worst affected region in 2009 with a loan portfolio risk rate of 9.23%. The poor performance was as a result of the global economic crisis of 2008 and 2009. The situation was worsened by the fact that, the MF industry of EECA advanced more loans and also made credit easily available to potential home owners in the region, as there was a real estate boom within the period of 1997 to 2006. Losses in the

housing business due to a decline in the housing prices led to the significant lose in loan advances.

In addition, the Latin America and the Caribbean (LAC), recorded the highest loan portfolio at risk in the industry for the year 2000 (5.00%) and 2001 (7.92%). Also, in the year 2003 and 2004, Latin America and the Caribbean experienced a steady decrease in their loan portfolio at risk at rate of 7.83% and 7.76% respectively although they were the region with the highest loan portfolio quality. However, in 2004, LAC was able to minimise their portfolio risk to a rate of 4.17% below the regional weighted average rate of 5.04% for the period of the study. The Middle East and North Africa (MENA) region is the next to indicate a high performance of loan portfolio risk management. The region had a loan portfolio risk below 5% during the study period and was not affected by the global economic crisis of 2008 and 2009. The steady high performance could be as a result of the difference in the Islamic financial system and the financial system in the other regions. An answer to the high performance could be the prohibition of fixed or specific interest charges for loan advancement called “Riba”. Likewise the strict request of collateral before loan application and the lack of additional penalties for delay in loan repayment could be a contributing factor for the low loan portfolio risk accounted by the MENA region. The south Asia region had a consistent and continues decline in their loan portfolio risk from the year 2003 to 2007. The SA region showed a rate of 6.49% in 2003, 6.17% in 2004 and 4.33%, 3.63% and 1.82% for the 2005, 2006 and 2007 respectively. On the other hand SA region also saw a considerable raise in their loan portfolio in 2010 (15.52%) due to their inability to recover from the economic crisis that hit the global market.

Recommendations and Conclusions

In conclusion, the study reveals that, Sub Saharan Africa experienced the highest effect of loan portfolio risk over the period of study. The region recorded the highest score of 0.863. This could be as a result from the lack of predictive power on behalf of the MFIs since the lenders don’t proved MFIs with reliable and accurate information which increases the chance of adverse selection. Furthermore, the lack of information sharing among MFIs could have resulted in the increases of loan portfolio risk within the region as MFIs are unable to recover their loans and

advances as a result of loans granted to serial defaulters. This tends to increase credit losses. Likewise, inefficient credit administration system such as not checking credit risk routinely and not monitoring monthly trends in delinquency, including a portfolio-at-risk aging schedule among other factors might have contributed to SSA recording the highest loan portfolio at risk. In order to improve on loan portfolio risk with the sub region, there is the need to empirically examine factors that contributed to the high rise of loan portfolio at risk in the Sub region within the period of study, therefore the need to examine the factors that affect loan portfolio at risk in SSA.

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