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Recovery of credit funds by Microfinance Support Centre. What are the challenges?

Overview

One of the objectives of the second National Development Plan (NDP II) is to increase access to finance through diversification and promotion of financial products and services that are tailored to the needs of the population and support the development of Microfinance Institutions (MFIs).

The Microfinance Support Centre (MSC) was established in 2001 to contribute to the pursuance of the objective of increasing access to credit and has cumulatively offered Ug shs 256 billion to the zonal offices that advance to the lower microfinance institutions for onward lending by individuals as loans. By 31st December, 2016 the loan recovery rates were not satisfactory as 19% of the total loan portfolio had arrears.

Poor loan recovery rates affect credit provision given that the government has not recapitalized the MSC in the last 15 years. The reflows therefore form the most reliable source of credit funds for the MSC strategies aimed at effective and efficient recovery of credit needed for meaningful contribution to increased access to finance.

This policy brief therefore analyses challenges encountered in loan recovery and recommends measures to MSC for effective loan recovery.

Key Issues

a) Diversion of funds to private activities.
b) MSC zonal offices are understaffed
c) Political leaders interfere and affect borrowers' willingness to repay**.**
d) Slow disposal of cases filed in courts.
e) Unforeseeable weather changes (affects farmers)**.**
f) Fraud and mismanagement caused by poor accounting practices, procedures and policies that include;
- Lack of client due diligence, and
- Weak internal control systems, policies and procedures.

Introduction

The Microfinance Support Centre (MSC) is a Company Limited by guarantee, fully owned by Government of Uganda (GoU) with the mandate to manage the Rural Microfinance Support Project (RMSP) and any other Government supported micro credit programmes.

The main objective of the MSC is to provide financial services to the economically active poor Ugandans through Savings and Credit Cooperatives Organizations (SACCOs), Small and Medium Enterprises (SMEs), Co-operative Unions, Producer and Marketing Co-operatives, and Teachers' SACCOs. It has so far executed its mandate through the implementation of five-year strategic plans, during which credit and capacity building services were extended to over 2,000 partner organizations in the country.

In order to take services nearer to the communities, the Centre offers services through 12 zonal offices across the country, with each office serving an average of 10 districts. The MSC offers a number of products like; Agricultural loans, Environmental loans, Special interest group loans, Commercial loans, and SME loans.

Recent Performance

The MSC quarter 2 progress report (October-December 2016) under the pillar of organizational sustainability planned to maintain Cost Income ratio at least1:1, increase level of staff productivity, improve risk management, improve governance, increase annual and cumulative loan collections and maintain Portfolio At Risk[1] (PAR) at 5% and below.

In FY 2016/17, Cost to Income ratio was 0.9:1 (Cost=Ug shs 3.085Billions and Income=Ug shs 3.120Billion). This was within the target of maintaining Cost: Income at least at 1:1.The PAR greater than 30 days was 13.9% as at December 2016, reflecting a decline in performance from 12% in the previous quarter. The PAR has been on a declining trend over the first two quarters to December 2016, implying that more funds are at risk of not being recovered from borrowers by the MSC.

A trend analysis shows a significant decline in recovery (Progress report Quarters 1 and 2: 2016/17) for credit funds by the Zonal microfinance support centres. The target PAR is 10% and the overall PAR registered was 19%. This indicates a high risk of non-recovery of loaned funds (Table 1).

Table 1: Aged Portfolio at Risk (PAR) for the Quarter Ending December 2016

ZONES	PAR>1 Day (%)	1-30 days (%)	31 - 60 days (%)	61 - 90 days (%)	91 - 270 days (%)	271– 365 days (%)	Over 365 days (%)	Total Loan Portfolio with arrears (%)
Arua	34.43	9.81	10.45	0.00	13.64	0.00	0.52	34.43
Gulu/Lira	26.02	11.33	3.36	3.34	7.37	0.00	0.62	26.02
HeadOffice	1.58	0.70	0.00	0.00	0.00	0.00	0.88	1.58
Hoima	22.13	14.66	0.00	0.00	7.47	0.00	0.00	22.13
Jinja/Igang	14.67	0.93	0.00	0.75	12.70	0.00	0.28	14.67
Kabale	8.28	2.58	4.95	0.00	0.33	0.21	0.21	8.28
Kabarole	18.35	1.32	15.04	1.55	0.45	0.00	0.00	18.35
Kampala	29.04	5.35	0.22	0.22	3.67	1.32	18.26	29.04
Masaka	13.61	4.42	4.26	0.00	1.02	0.00	3.91	13.61
Mbale	14.32	7.07	0.00	3.81	2.43	1.01	0.00	14.32
Mbarara	5.68	5.55	0.00	0.00	0.00	0.00	0.14	5.68
Moroto	10.04	9.30	0.00	0.36	0.38	0.00	0.00	10.04
Soroti	69.19	28.95	9.88	22.16	2.38	5.82	0.00	69.19
Overall	**19.0**	**13.9**	**3.7**	**0.7**	**2.4**	**0.6**	**6.5**	**19.0**

Source: Headquarters and Field Findings

[1] PAR represents the funds loaned out that have outstanding arrears of principle and interest.

Head Office improved the PAR from 15% in Quarter II to 1.58% and Kampala Zone from 36% in the previous Quarter to 29.04%. The rest of the zones experienced a decline in the quality of their portfolios. Soroti zone registered the worst PAR of 69% from 59% in Quarter 1 due to default from one main client with 60% of the portfolio.

At the end of Q2 FY 2016/17 SMEs and SACCOS (excluding Teachers' SACCOs) constituted the biggest number of loans in default at 47.2% and 30.4% respectively. This was due to;

- SMEs take the biggest amounts of loans and their delinquency puts the company portfolio at high risk.
- Most SACCO loans are unsecured thus the risk of loss is high. Recovery of the unsecured loans is also slow and expensive.

Challenges in recovery of credit funds

Diversion of funds: Diversion of funds by clients affect repayment rates for example, 50% of the cases reported by MSC in FY 2016/17 arose from clients diverting funds to private use. Some of the companies with arrears and outstanding loans respectively included; UNI Oil-Ug shs 988m and a loan of Ug shs 1.3billion, Uganda Academic Enhancement Company Ltd-Ug shs 78m and a loan of Ug shs 256m, UTODA *Awakula Ennume* Ug shs 1.7billion and a loan of Ug shs 1.9billion.

Understaffing: The MSC zonal offices are understaffed hence face difficulty in adequately monitoring the activities of several SACCOs in different districts. Field findings by the Budget Monitoring and Accountability Unit (BMAU) in January 2017 indicated that Soroti zonal office had one credit officer who doubled as the manager and had to cover 8 districts. Although an increase in clientele was noted, implementation of SACCOs' action plans, supervision of services and recovery of funds was problematic.

Unforeseeable weather changes: This basically affected farmers whose repayment rate is dependent on favorable climate. However, they were affected by unpredictable weather patterns and climate changes for example prolonged drought, pests, diseases and storms; and yet agricultural loans tend to constitute the highest value of loans issued to client.

Political interferences: Political utterances from leaders such as Resident District Commissioners (RDCs) who undermine SACCO objectives. Members think that the borrowed funds are donations from government, for example in Amuria district the then RDC borrowed from Asamuk SACCO and was not willing to refund because of the perception that these are "government funds''.

Slow disposal of cases filed to courts: In its effort to recover loans, the MSC has attached property and sued clients. In some instances however, this process is affected by prolonged court durations to dispose of cases and instant release of suspects by the police for lack of evidence.

Fraud and mismanagement: There is increasing fraud by management and board members of SACCOs that ultimately affects the ability of SACCOs to repay the loans borrowed from the MSC. Some of the factors identified among those responsible for fraud and mismanagement in MSC clients included: weak corporate governance, poor accounting practices, procedures and policies, lack of client due diligence among others. Although there was a reduction registered in the number of SACCOs with fraud incidents, some isolated cases were reported like in Nakapiripirit SACCO, and Taala Ya Mawogola SACCO.

Conclusion

The MSC has continued to register a steady rise of loan defaulters mainly due to inadequate application of tools of credit policy management and internal weaknesses of the microfinance institutions. This is manifested through challenges that include; diversion of funds by institutions, understaffing of MSC zonal offices, political interferences and fraud and mismanagement. These require a concerted approach to address them as proposed in the recommendations.

Recommendations

1. The MFPED in partnership with the MSC should fast-track the operationalization of the recently passed Tier 4 Micro Finance Institutions and Money Lenders Act that seeks to enforce regulation and control of Microfinance institutions including SACCOs. This will involve completion of the regulations and massive sensitization of all stakeholders.
2. The MFPED-Financial Services Department should partner with Ministry of Local Government (MoLG) and Ministry of Trade, Industry and Cooperatives (MoTIC) in sensitizing stakeholders including political leaders to appropriately communicate the objectives of the credit funds and importance of loan repayments.
3. The MSC should fill the vacant positions especially for credit officers in the respective zonal offices to ensure adequate staffing levels to handle the tasks and hence contribute to improved service delivery.
4. Most of the MSCs operate in rural areas where greater proportions of clients are illiterate. Through the business development services programme and partnership with MFPED-Program for Financial Inclusion in Rural Areas (PROFIRA) should build capacity of their clients on loan utilization and management from the acquisition of loans to repayment stage.
5. The MSC should incentivize agricultural and environmental loans that prioritize irrigation and environmental protection through longer grace periods to avoid default by farmers who are affected by the climate changes.

Reference

1. MFPED-Semi-Annual Budget Monitoring Report March 2016/17.
2. Microfinance Support Center Quarter 1&2 Progress Report Oct-Dec 2016/17.
3. Government of Uganda, Second National Development Plan (NDPII) 2015/16-2019/20
4. Microfinance Support Centre, Strategic Plan (2014-19).

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