GEO

Guyana Economic Opportunities

IPED Cash Flow Lending and Delinquency Management Training Workshops February 25 – March 10, 2001

Course Material

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INTRODUCTION

The two training courses on Cash Flow Analysis and Delinquency Management were presented to the credit officers and accounting staff of the Institute of Private Enterprise Development (IPED). The purpose was to upgrade their skills in determining appropriate loan sizes and terms for clients, and to deepen their knowledge of loan delinquency, its nature and effects on the lending institution. Measures were also identified for controlling it. The design and materials for the training were adapted from those of a USAID-assisted micro-finance project in the Philippines, the Microenterprise Access to Banking Services (MABS).

The four-day training was held at the Grand Coastal Inn on the East Coast of Demerara, with 15 participants for the first session on March 2nd and 3rd, 2001 and 16 participants for the second and final sessions on March 7th and 8th 2001.

Cash Flow Lending

Powerpoint Presentation Slide

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Welcome!

to the

GEO-IPED

Workshop on Cash Flow Analysis & Delinquency Management

Grand Coastal Inn

March 7-8, 2001

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What is Cash Flow Lending?

Slide 3

OBJECTIVES

- To determine what cash flow lending is as opposed to other types of lending;
- To emphasize the importance of cash flow analysis in lending to microenterprises

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Three Basic Types of Lending

- Asset-Based Lending
- Project-Based Lending
- Cash Flow Lending

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Asset-Based Lending

Loan is granted based on the value of the property offered as collateral/ security

- determining income as source of payment is of secondary importance
- timing of payments are based on agreed period, rather than the period of cash inflow

  Ex. Pawnshop lending, some REM-based loans

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Advantages of Asset-Based Lending

- Lending appears to be less risky

- Loan amount is based on the value of the security and therefore relatively easier to determine

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Disadvantages of Asset-Based Lending

Greater risk of loan delinquency and default, since:

- Loan size is not based on borrower's repayment capacity
- Repayment schedule is not based on borrower's cash flow
- Value of properties could fluctuate

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Project-Based Lending

- Form of cash flow lending, which is based on the *future* or expected cash flows of the project or activity to be financed
- Collateral is a secondary consideration; primary consideration is the viability of the project

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Advantages of Project-Based Lending

- Repayment schedule is based on the cash flows of the project
- Start-up projects can be financed so that target borrowers would have easier credit access
- Best suited for development or poverty-focused credit programs

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Disadvantages of Project-Based Lending

- Highly vulnerable to diversion of loan proceeds by the borrowers
- Highly vulnerable to various project risks
- Requires elaborate analysis of feasibility and viability of the project

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What is Cash Flow Lending?

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Cash Flow-Based Lending

- Based on the borrower's *present* cash flows
- Loan amount is based on the capacity of the borrower to repay
- Repayment schedule is based on the borrower's timing of cash flows
- Collateral is not the primary consideration
  Ex. Microenterprise loans, salary loans, business loans

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Advantages of Cash Flow Lending

- Risk of default risks due to diversion of loan proceeds is minimized
- Loan sizes, terms, and repayment schedules are based on the client's cash flows
- Best suited for working capital loans

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Disadvantages of Cash Flow Lending

- Conservative loan sizes
- Initially, could work against low-income clients
- Not the best tool for determining the loan requirement of projects needing capital expenditures or long-term investments

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Why is Cash Flow Analysis Important in Microenterprise Lending?

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Why important?

Gives the bank ideas on…

- How much loan a prospective client can afford to pay
- How long the term of the loan should be
- How frequently (daily, weekly, fortnightly, monthly) the client would be able to repay

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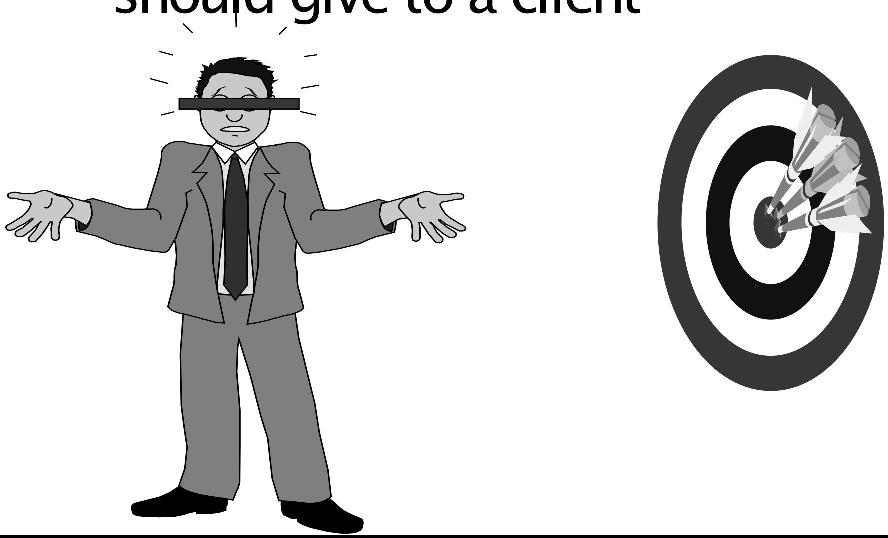
Lending to Microenterprises without analyzing the cash flow….

…is like playing darts blind-folded to determine how much loan the bank should give to a client



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Determining the Client's Cash Flow

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Session Objectives

(1) Know the *pre-requisites* in determining the client's cash flow;

(2) Develop skills in estimating and analyzing Cash Flow for microenterprises

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Pre-requisites to Analyzing the Client’s Cash Flow

- Review the information supplied in the Loan Application Form
- Gather additional information through Credit Investigation/Background Investigation (CI/BI)
- Formulate assumptions that will be used in preparing the client’s cash flow

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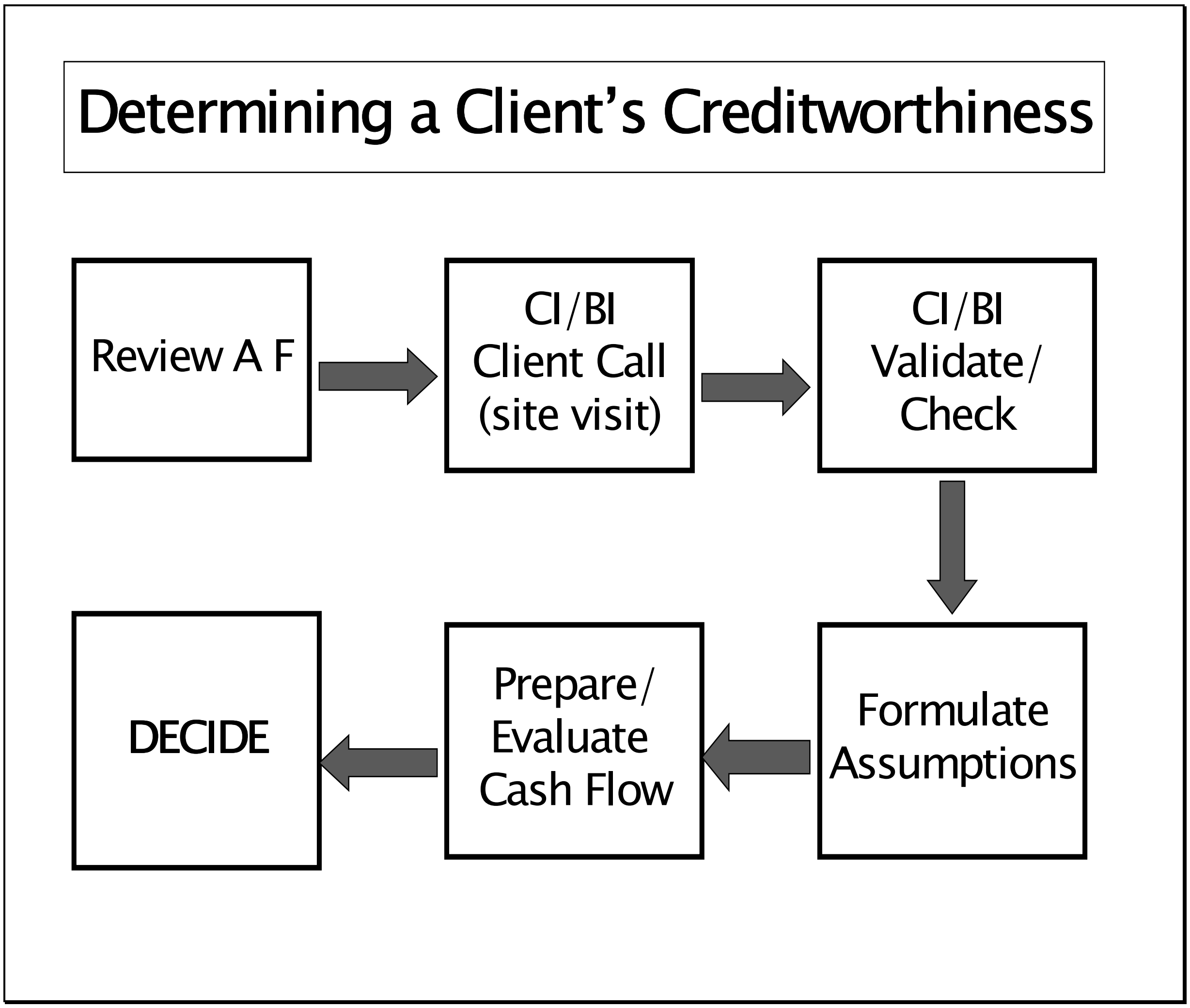
Determining a Client's Creditworthiness
Review A F
CI/BI
Client Call
(site visit)
CI/BI
Validate/
Check
Formulate
Assumptions
Prepare/
Evaluate
Cash Flow
DECIDE

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What Every Loan Officer Needs to Know

- Client's personal & household data
- Business sources and uses of cash
- Household sources and uses of cash
- Timing of cash receipts and disbursements
- Knowledge of the client's business (market, production processes, potential risks)

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Sources of Information

- Loan application form
- Client interview
- Client references
- Other key informants (neighbors, suppliers, creditors)
- Records of other financial institutions
- Judicial records
- Other documents (e.g. utility bills)

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Credit/Background Investigation

Reviewing the Loan Application Form

Nature of the business	Location of the business
Amount of loan	Purpose of loan
Loan Term	Size of Installment
Reported Incomes	Reported Expenses

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Credit/Background Investigation

Client Call (site visit)

Observe	Ask
Capacity of the business	Details of income
Customer turnover	Details of expenses
Facilities available	Business plans

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Credit/Background Investigation

Validation

Independent Sources

Residence & business neighbors

Suppliers & creditors

Market Administrator

Judicial courts

Bank records

Light & water bills/ House rental payment

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Formulating the Assumptions

Business Sources of Cash

- ✓ Operating days and hours? Peak? Slow?
- ✓ Capacity at peak? Capacity at slow?
- ✓ Customers? Normal amount spent?
- ✓ Other products/services offered?
- ✓ Prices

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Formulating the Assumptions

Business Uses of Cash

- ✓ Primary Purchases/Raw Materials
- ✓ Volume? Amount?
- ✓ Frequency of purchase?
- ✓ Other purchases? Volume? Amount?
- ✓ Labor? Paid? Family? Subsidies?
- ✓ Utilities? Other expenses?
- ✓ Loans payments? Amount? Terms?

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Formulating the Assumptions

Household Sources of Cash

- ✓ Income of other family members
- ✓ Amount
- ✓ Regularity and frequency of flows

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Formulating the Assumptions

Household Uses of Cash

- ✓ Regular expenses? Food? Clothing? House Rent? Education? Utilities?
- ✓ Loans? Appliance? Housing? Vehicle? Salary loan?
- ✓ Extraordinary expenses? Medical bills? Education of siblings? Parents' allowance?
- ✓ Amount and frequency of expenditures?

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Preparing the Cash Flow

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Preparing the Client's Cash Flow

The Cash Flow Format

- Presents the cash flows of both the business and the household

  Microenterprise operators generally do not keep track of the income and expenses of the household & business separately
- Assumes that regular business and household expenses are of higher priority than the payment of the proposed loan
- Records the various flows of the business and household income and expenditures as they occur

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Preparing the Client's Cash Flow

The Cash Flow Format (cont.)

- Repayment capacity is adjusted for:
  - –Unforeseen circumstances that affect cash flow which could either reduce income or increase expenditures
  - –Possible errors in the assumptions or estimates

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Recording of Transactions

- The cash flow format has a column for daily, weekly, fortnightly and monthly flows
- Record the transaction in the appropriate column (i.e. under the daily column for daily income and expenditures, etc.)
- Convert all entries into their monthly equivalents under the TOTAL column
- In converting daily entries to their monthly totals, multiply the daily entries by the relevant number of days (max. 30 days), weekly entries by 4, and fortnightly entries by 2.

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Debt Capacity Assessment

- Select the most appropriate column. If daily installments are allowed, use this column. If not, use the weekly column.
- Convert the net income values of the various columns into their daily or weekly equivalents by multiplying or dividing them by the relevant number of days
- Only convert the values of those columns with negative net income values. Do not include those with positive net income values, except those column(s) to the left of the selected column.

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Debt Capacity Assessment

- Estimate the amount available for debt service by adding up the values appearing in the column
- Adjust the repayment capacity by multiplying the amount available for debt service by the appropriate factor (e.g. 35%)
- Estimate the maximum amount of the loan by using the formula:

$$\frac{\text{(Adjusted repayment capacity)} \times \text{(\# Installments)}}{1 + \text{(Monthly interest rate} \times \text{max. \# months)}}$$

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To Determine the Shortest Term Within Which the Client Can Pay the Loan

- Estimate the max. size of each installment, by dividing the max. loan amount by the max. number of installments (i.e. if 6 mos. is the max. term, max. # installments will be 24 weekly or 12 fortnightly installments
- Then, divide the proposed loan amount by the the max. size of each installment
- However, the term of the loan can only be shortened if the estimated max. loan that can be given to the client is greater than the amount of his/her proposed loan

CASH FLOW FORMAT

Item	Daily	1-2x A Week	Once Every Fortnight	Once a Month	MONTHLY TOTALS
Income From Business					
Business 1:					
Business 2					
Business 3					
Total Business Income					
Business Expenses					
Raw Materials/Purchases					
Business 1:					
Business 2					
Business 3					
Salaries & Wages					
Rent					
Utilities					
Transportation					
Fuel					
Business Loan Payments					
Business Taxes & licenses					
Other business expenses					
Total Business Expenses					
NET BUSINESS INCOME					
Other Household Income					
Salaries & Wages					
Pension					
Remittances from other family members					
Other Income Sources					
Total, Other Household Income					
TOTAL BUSINESS & HH INCOME					
Household Expenses					
Food					
House rent					
Education and School Allowance					
Utilities					
Transportation					
Fuel					
Medical expenses					
Other loan payments					
Other expenses					
Miscellaneous expenses					
Total Household Expenses					
NET BUSINESS & HH INCOME					
DEBT CAPACITY ANALYSIS					
Equivalent of DAILY net income					
Equivalent of WEEKLY net income					
Equivalent of FORTNIGHTLY net income					
Equivalent of MONTHLY net income					
Amount available for debt service					
Adjusted Debt Capacity: 35%					
Max. loan amount for _ months (__ inst.)					

Business 2	a (6 days)				= (a) * 24 days
Business 3	a (5 days)				= (a) * 20 days
Total Business Income (A)					

Business Expenses					
Raw Materials/Purchases					
Business 1:		b			= (d) * 4 weeks
Business 2			c		= (e) * 2
Business 3				d	= (f) * 1
Salaries & Wages					
Rent					
Utilities					
Transportation					
Cooking fuel					
Business Loan Payments					
Business Taxes & licenses					
Other business expenses	a (7 days)	b	c	d	= (a*7) + (b*4) + (c*2)+ (d)
Total Business Expenses (B)					

NET BUSINESS INCOME (C) **=**A-B					

Other Household Income					
Salaries & Wages					
Pension					
Remittances from other family members					
Other Income Sources					
Total, Other Household Income (D)					

TOTAL BUSINESS & HH INCOME (E)= C+D					

Household Expenses					
Food					
House rent					
Education and School Allowance					
Utilities					
Transportation					
Cooking fuel					
Medical expenses					
Other Loan Payments					
Other expenses					
Miscellaneous expenses					
Total Household expenses (F)					

NET BUSINESS & HH INCOME (G) = E-F	Gd	Gw	Gf	Gm	

DEBT CAPACITY ANALYSIS					
Equivalent of DAILY net income		=Gd*7 days			
Equivalent of WEEKLY net income		=Gw			
Equivalent of FORTNIGHTLY net income		=Gf/2			
Equivalent of MONTHLY net income		=Gm/4			
Amount available for debt service		Total			
Adjusted Debt Capacity: 35%		=Total *0.35			
Max. loan amount for _ months (__ inst.)		(Adjusted Debt Capacity) * (Total No. of Weekly Installments 1 + (Interest rate per month * No. of Months)			

Cash Flow Analysis: Case Studies

CASH FLOW SAMPLE DATA SHEET

Nazilla's Pastry Business

Nazilla, married to Douglas, is engaged in the business of pastry- making. The spouses have two children, aged 5 and 2 years. They live in a house they have recently built from the proceeds of a government housing loan.

Nazilla is applying for a loan of $35,000. She wants to use the loan for increasing her production of pastries as she expects to get a lot of orders in the coming weeks.
`

During the interview, you were able to obtain the following information from Nazilla.

Business Financial Data

1. Nazilla produces and sells 350 pieces of assorted pastries daily which she sells, on average, at $20 apiece.

2. She sells the pastries, on consignment basis, through three school canteen operators. In return, the school canteen operators get 15% of the daily sales.

3. Nazilla buys her baking ingredients, consisting of flour, milk , sugar, eggs, coconut milk, and other supplies every week. She spends a total of $15,000 per weekly purchase.

4. Nazillla has a part-time helper in her business, who only works during weekends and whom she pays $400 per week.

5. On weekends, Nazilla also sells decorative items made out of dried flowers. From this activity, she earns an average of $1,125 per week. She spends $500 per week for the materials she uses in making these items.

Household Financial Data

9. Douglas, on the other hand, is employed as a bookkeeper in a construction company where he is paid a salary of $28,000 per month. He brings home a net pay of $17,000. His housing loan installment payments are deducted from his salary and remitted directly by the company to a local branch of a government bank.

10. Douglas also owes a small loan from a local credit cooperative, which he pays $1,500 every month. It is reported that Douglas is up to date with his payments.

11. The eldest child is enrolled in a nursery school and the school fee has been fully paid until the end of the school year. The boy is given a daily allowance $20 from Monday to Friday.

12. The family also spends for the following: $5,500 per week for food; $700 weekly for transportation; $1,800 monthly for utilities (light and water bills); $1,500 monthly for LPG fuel; and $1,500 weekly for miscellaneous expenses.

In determining the maximum loan amount that could be given to Nazilla, assume that:

- the maximum loan term that could be given by your bank is 6 months (24 weeks)
- Repayments will be in weekly installments
- Adjusted Repayment Capacity Rate = 35%
- Interest rate is 4% per month, computed on a flat-rate basis

CASH FLOW ANALYSIS: Nazilla's Pastry Business					
Item	**Daily**	**1-2x A Week**	**Once Every Fortnight**	**Once a Month**	**MONTHLY TOTALS**
Income from Business					
Business 1: Pastries	7,000				140,000
Business 2: Decorative items		1,125			4,500
Business 3:					-
Total Business Income	7,000	1,125	-	-	**144,500**
Business Expenses					
Raw Materials/Stock Purchases					
Business 1: Pastries		15,000			60,000
Business 2: Decorative items		500			2,000
Business 3:					
Salaries & Wages		400			1,600
Rent					
Utilities					
Transportation expenses					
Cooking fuel					-
Business Loan Payments					-
Others: Sales commission	1,050				21,000
Other business expenses					
Total Business Expenses	1,050	15,900	-	-	**84,600**
NET BUSINESS INCOME	5,950	(14,775)	-	-	**59,900**
Other Household Income					
Salaries & Wages: Spouse				17,000	17,000
Pension					
Remittances from other family members					
Others					
Total, Other Household Income	-	-		17,000	**17,000**
TOTAL BUSINESS & HH INCOME	5,950	(14,775)	-	17,000	**76,900**
Household Expenses					
Food		5,500			22,000
House rent					-
Education and School Allowance	20				400
Utilities				1,800	1,800
Cooking fuel				1,500	1,500
Transportation		700			2,800
Medical					
Insurance					
Other Loan Payments				1,500	1,500
Miscelllaneous expenses		1,500			6,000
Total Household expenses	20	7,700	-	4,800	**36,000**
NET BUSINESS & HH INCOME	5,930	(22,475)	-	12,200	**40,900**
DEBT CAPACITY ANALYSIS					
Equivalent of DAILY net income		29,650			
Equivalent of WEEKLY net income		(22,475)			
Equivalent of FORTNIGHTLY net income					
Equivalent of MONTHLY net income					
Amount available for debt service		7,175			
Adjusted Debt Capacity @ 35%		2,511			
Max . Loan Amount for 6 mos. (24w)		**48,605**			

<u>GEO-IPED WORKSHOP</u>

<u>CASHFLOW LENDING TO MICROENTERPRISES</u>

Vending: Jenny's Shop

Jenny operates a shop, which is located just in front of the house which she and her husband is renting for $20,000 a month. Her husband, Joseph, does not have a regular job. They have 3 children. Jeffrey, 14, is a high school student; Juliet, 10, a 4th grade student in a public school; and Bob, 3 years old. School expenses amount to $3,000 a month.

Jenny provided the following information on her business and household income and expenses. Her peak sales are on Saturdays and Sundays at $15,000 a day. Regular sales occur from Mondays to Thursdays amounting to $7,500 a day. Lowest sales usually occur during Fridays at $3,750.

The buying and selling prices of the five most saleable items in Jenny's shop are as follows:

Item	Quantity	Buying price	Selling price
1. Rice	25 gallons	$200/gallon	$250/gallon
2. Cooking oil	20 pints	$84/pint	$100/pint
3. Soda	24 bottles	$33/bot.	$40/bot.
4. Cheese	20 lbs.	$360/lb.	$450/lb.
5. Cigarettes	50 packs	$115/pack	$150/pack

Jenny normally maintains an inventory level of two weeks. She replenishes her stock of merchandise regularly every week. Her average weekly purchases amount to $52,000.

Daily household expenditures include: food, $450/day; and transportation, $50/day.
Miscellaneous expenditures are incurred daily amounting to $100.
Monthly expenses include: utilities, $1,200/month; cooking gas, at $1,500, and payments for a refrigerator that was bought on installment basis, at $2,625.

Jenny is applying for a loan amounting to $20,000 for additional working capital.
Maximum loan term is 6 months.
Interest rate is 4% per month.
The loan is to be repaid in weekly installments.
Debt capacity adjustment factor is 35%.

Cash Flow Worksheet: Jenny's Shop

Average Daily Sales

Monday	7,500
Tuesday	7,500
Wednesday	7,500
Thursday	7,500
Friday	3,750
Saturday	15,000
Sunday	15,000
Total Weekly Sales	63,750
Average Daily Sales	**9,107**

Average Price Mark-Up

Item	Qty.	Buying Price/Unit ($)	Selling Price/Unit ($)	Total Cost ($)	Total Sales ($)	Average Mark-Up
Rice	25 gallons	200	250	5,000	6,250	
Cooking Oil	20 pints	84	100	1,680	2,000	
Soda	24 bottles	33	40	792	960	
Cheese	20 lbs.	360	450	7,200	9,000	
Cigarettes	50 packs	115	150	5,750	7,500	
TOTAL				20,422	25,710	**25.9%**

Cost of Goods Sold = or Amount of Minimum Weekly Purchases

$$\frac{\text{Total Weekly Sales}}{1 + \text{Average Price Mark-Up}}$$

$$\frac{(9{,}107) * 7}{1 + 0.26}$$

$$\frac{63{,}750}{1.26}$$

GEO-IPED Workshop

CASHFLOW LENDING TO MICROENTERPRISES

CASE STUDY: Small Restaurant

Vanessa operates a small restaurant located within a busy commercial district. She is married to John and they have two children, aged 5 and 3. John works as a teller at a bank. The family live in a house built by the couple through a bank loan.

During the client interview, the following information were gathered.

A. General Information and Sales:

1. Restaurant has 5 tables; 4 chairs per table
2. Equipment: soft drink cooler, TV with cable, pots and pans, utensils, upright freezer, 3 LPG tanks, 4 gas burners, 1 charcoal-fueled stove (for boiling), grill.
3. Operating hours: 6:00 am to 9:00 pm
4. Operating days: Mondays to Saturdays
5. Peak hours: Noon - 11:00 - 2:00 (35 customers)
PM - 6:00 - 8:00 (10 customers)
6. Non-peak hours: rest of the day, total of about 5 customers
7. Average spending per customer: $275 per meal.
8. Other products: Restaurant also sells daily a total of 1 case (24 bottles) of soda at $40 per bottle and 1 case (24 bottles) of beer at $150 per bottle.
9. Leftover: usually none. If there is any, family takes food home.

B. Business Expenses

1. Primary purchases

Item	Volume	Cost ($)	Frequency
Pork	6 lbs.	180//lb	Daily
Beef	6 lbs.	200/lb	Daily
Chicken	6 lbs.	150/lb	Daily
Fish	2 lbs	150/lb	Daily
Assorted Veggies	2 lbs.	85/lb	Daily
Soft drinks	6 cases	720/case	Weekly
Beer	6 cases	2400/case	Weekly

2. Other purchases (e.g. other cooking ingredients and an LPG tank) are done weekly. Purchases of other ingredients average $4,000 weekly while an LPG tank would cost $1,500 each.
3. Restaurant workers: 1 cook at $28,000 per month and two servers at $12,000 each per month. The cook is paid every week while the 2 servers are paid on a monthly basis.
4. Utilities: Based on bills of last 3 months: water bill averages $1,500 per month while electricity averages $3,000 per month.
5. Rent paid for the restaurant = $50,000 per month.
6. Business tax is 3% of gross sales and paid on a monthly basis.

C. Household Income

1. John's monthly salary is $37,500. His take-home pay, though, is only $7,000 every fortnight after deducting for the payments of his housing loan and a salary loan.

D. Household Expenses

Item	Amount	Frequency	Remarks
Food	$200	Daily	Husband brings lunch to work
House rent	$40,000	Monthly	
Water	$500	Monthly	
Electricity	$2,000	Monthly	
Telephone	$2,000	Monthly	
Gas for vehicle	$2,500	Weekly	
Insurance	$6,000	Monthly	Life insurance premium for both couple
Vehicle Loan	$12,000	Monthly	Installment payment for the vehicle loan
Appliance Loan	$4,000	Monthly	For a color TV acquired through installment payments

E. Other Information

1. Vanessa regularly sends her parents a monthly allowance of $15,000.
2. John is also sending a younger sister to high school. The yearly tuition has already been paid but she requires spending money of $1,000 per week.
3. Miscellaneous household expenses is estimated to be about $5,000 per week
4. Assumptions of the loan application:
    - Loan amount being applied for by Vanessa is $75,000
    - Loan interest is 4% per month (flat rate, add-on)
    - Max. Term is 6 months (24 weeks)
    - Repayment is on fortnightly basis
    - Adjusted Repayment Capacity Rate = 35%

CASHFLOW ANALYSIS: Vanessa's Restaurant					
Item	**Daily**	**1-2x A Week**	**Once Every Fortnight**	**Once a Month**	**MONTHLY TOTALS**
Income fron Business					
Business 1: Meals & drinks	18,310				439,440
Business 2					
Business 3					
Total Business Income	18,310	-	-	-	439,440
Business Expenses					
Raw Materials/Purchases					
Business 1: Meals & drinks	3,650	22,720			178,480
Business 2					
Business 3					
Salaries & Wages		7,000		24,000	52,000
Rent				50,000	50,000
Utilities				4,500	4,500
Transportation expenses					
Fuel: Cooking gas		1,500			6,000
Business Loan Payments					
Business Taxes & licenses				13,183	13,183
Other business expenses					
Total Business Expenses	3,650	31,220	-	91,683	304,163
NET BUSINESS INCOME	14,660	(31,220)	-	(91,683)	135,277
Other Household Income					
Salaries & Wages: Spouse			7,000		14,000
Pension					
Remittances from other family members					
Other Income Sources					
Total, Other Household Income	-	-	7,000	-	14,000
TOTAL BUSINESS & HH INCOME	14,660	(31,220)	7,000	(91,683)	149,277
Household Expenses					
Food	200				5,600
House rent				40,000	40,000
Education and School Allowance		1,000			4,000
Utilities				4,500	4,500
Transportation: Gas for vehicle		2,500			10,000
Medical expenses					
Insurance premium				6,000	6,000
Other Loan Payments: Vehicle				12,000	12,000
Other Loan Payments: TV				4,000	4,000
Other expenses: Parents' allowance				15,000	15,000
Miscellaneous expenses		5,000			20,000
Total Household expenses	200	8,500	-	81,500	121,100
NET BUSINESS & HH INCOME	14,460	(39,720)	7,000	(173,183)	28,177
DEBT CAPACITY ANALYSIS					
Equivalent of DAILY net income			173,520		
Equivalent of WEEKLY net income			(79,440)		
Equivalent of FORTNIGHTLY net income			7,000		
Equivalent of MONTHLY net income			(86,592)		
Amount available for debt service			14,488		
Adjusted Debt Capacity @ 35%			5,071		
Max. Loan Amount for 6 months (12 inst.)			**49,074**		

Delinquency Management

Slide 1

The Nature & Effects of Loan Delinquency

Slide 2

What is Loan Delinquency?

- Also referred to as arrears or late payments
- Any account with a missed payment of even one day is a delinquent account

Slide 3

Characteristics of Loan Delinquency

- Delinquency and loan losses imply postponed income, lost income, and lost portfolio.
- Delinquencies should be understood as costs that have three special characteristics:
- First, they are hidden.
- Second, they are usually attributed to external factors
- Third, they are contagious.

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The Costs of Loan Delinquency

- Quantifiable Costs
  - Effects on Operating Costs
  - Effects on Income
  - Effects on Financial Condition
- Non-Quantifiable Costs

Slide 5

Effects on Operating Costs

- Additional costs incurred in closer monitoring, more frequent client visits, more extensive analysis of the loan portfolio, legal fees, costs associated with repossessing and selling foreclosed properties, etc.
- More time, resources and effort spent in controlling delinquency – less time for reaching new borrowers or expanding the bank's client outreach

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Effects on Income

- Delinquent loans imply delinquent interest, or postponed income
- Slower portfolio rotation, resulting in lower income from loan processing fees
- Loss of interest income when loans are eventually not paid
- Loss of interest income when lender give up on recovering the interest on past due loans and concentrate on just recovering the principal

Slide 7

Effects on Financial Condition

- Higher loan-loss reserves requirement
- Decapitalization of the loan portfolio, due to loan losses
- To be sustainable, lender will be forced to increase their interest rates to replace lost income from loan losses

Slide 8

Who pays for the costs of loan delinquency?

- Ideally, delinquent borrowers should pay for these costs through penalties for late payments and non-payment
- However, it is difficult to collect from delinquent borrowers. Eventually, good borrowers end up paying the costs through higher interest payments

Slide 9

Cost of Delinquency

Loan Portfolio Data		
Portfolio Size	100%	50,000,000
Delinquency Rate	20%	10,000,000
Revenue Generating Portfolio	80%	40,000,000
Interest Income	36%	14,400,000
Less: Cost of funds	13%	6,500,000
Less: Operating costs	10%	5,000,000
Less: Loan Loss Provisions	20%	10,000,000
Profits/(Loss)	-14%	-7,100,000

Slide 10

Benefits of Low Delinquency

Loan Portfolio Data:	The Bank of High Delinquency		The Bank of Low Delinquency	
Portfolio Size	100%	50,000,000	100%	50,000,000
Delinquency Rate	20%	10,000,000	2%	1,000,000
Revenue generating portfolio	80%	40,000,000	98%	49,000,000
Interest Income	36%	14,400,000	36%	17,640,000
Less: Cost of Funds	13%	6,500,000	13%	6,500,000
Less: Operating costs	10%	5,000,000	10%	5,000,000
Less: Loan Loss Provisions	20%	10,000,000	2%	1,000,000
Profits(/Loss)	-14%	-7,100,000	+10%	5,140,000

Slide 11

Non-Quantifiable Costs

- Deterioration of staff morale
- Breakdown of credit discipline among clients
- Loss of respect and trust in the bank by clients and funding sources
- Because of the lender's bad experience, other lenders will be more reluctant to lend to microenterprises
- Bad loans can ruin a microentrepreneur and plunge an entire family into desperate economic situation

Slide 12

Why is delinquency not acceptable?

- It reduces profitability
- It reduces the bank's competitiveness
- It affects the bank's image in the community negatively, resulting in loss of trust by its clients & funding sources

Can lead to

Bank Failure!

Delinquency Identification

Slide 1

How Would You Know If You Have a Delinquency Problem?

Now we are going to discuss the important topic of how to know whether we have a delinquency problem.

Slide 2

Delinquency Identification

- Proactive Focus
  – Best surprise is no surprise
- Information Driven Approach
  – Three key ratios
- Trend Analysis
  – Look at portfolio performance over time

When we speak about wondering whether or not we have a delinquency problem, its important to have information about the quality of the loan portfolio *before* a problem exists. The best surprise is no surprise.
While your staff may be well aware of a problem - since it is they who will know whether clients are paying are not - they may be afraid to tell you - afraid that they may get into trouble, not wanting to disappoint you, thinking that maybe the clients will start paying soon or that the problem will simply disappear all on its own. This is not going to happen… and to ensure that you are well aware of any problems long before it gets too serious to be able to correct, you need a good management information system. A system that both contains the right data and secondly, can produce the reports that you need.

As managers, loan supervisors, account officers, it is important that you have adequate information available in a timely manner.
In order to determine if you have a delinquency problem, you need to measure the quality of your loan portfolio. We will present three key ratios this morning that you should have available to you at any given time.
And finally, it is most necessary to look at these ratios (and other information) over time - to see if the delinquency situation is improving, deteriorating and whether what you have implemented is having the desired effect.

Slide 3

Data Required for Delinquency Analysis

- Number of Accounts with an amount past-due
- Amount of payments past-due
- Amount of outstanding portfolio with an amount past-due
- Number of days loans have been past due, split into ranges

Any good management information system should have the following information: (read from slide). Now, when I talk about "accounts with an amount past-due," I'm not referring to the traditional "past-due accounts" which are traditionally accounts past-due maturity. I'm referring to all accounts with missed payments or payments in arrears.

This information is necessary to calculate the portfolio quality ratios that will let you know if you have a delinquency problem -- just in case your staff doesn't.

One thing I want to point out here is that I have not listed the amount of loans that are past maturity. I'd like to go through a little exercise to demonstrate why past due maturity is not so important an indicator to analyze when looking at delinquency. Does anyone have a 500-dollar note? May I borrow it from you? (Take $500 note from person). Thank you. Now let's say that I agree to pay back Maria 100 dollars a month for 5 months. After 2 months Maria doesn't hear from me and I have not paid her back. If she was the bank and was only concerned about loans that were past due maturity she would not be worried, right? Wrong. Are you worried about the 200 dollars I borrowed or the 500 dollars I still owe you? Yes, the 500 dollars. This is what you "risk" losing if I continue not to pay you and what you should be concerned with, not your "past due maturity" We can discuss this further as we talk about calculating different delinquency ratios.

Slide 4

Identifying Delinquency

- Three Key Financial Ratios:
  - – Portfolio In Arrears Ratio
  - – Portfolio At Risk Ratio
  - – Loan Loss Reserve Ratio

OK, so the three key ratios that I think you should be looking at are: (read from slide). We will now go through them one-by-one...

Slide 5

Portfolio In Arrears Ratio

Definition:

$$\boxed{\frac{\text{Amount of Payments in Arrears}}{\text{Value of Loans Outstanding}}}$$

Data Required:

- Total amount of payments in arrears
- Total amount of loans outstanding

Considerations:

- May over-represent portfolio quality, particularly in a growth scenario

If we look back at the example I just talked about, the 200 dollars that I owe Maria are the payments in arrears and the value of my loan outstanding is 500 dollars, so if this was the only loan of the bank, my portfolio in arrears would be 200/500 or 40%.

Slide 6

Portfolio At Risk Ratio

Definition:

$$\frac{\text{Balance of Loans in Arrears}}{\text{Value of Loans Outstanding}}$$

Data Required:

- Total balance of outstanding portfolio with an amount in arrears
- Total amount of loans outstanding

Considerations:

- Conservative measure of portfolio risk (most important determinant of portfolio quality)

But as I mentioned to you before, Maria is not just concerned with the 200 dollars that I have not paid her over the past 2 months, but the whole 500 dollars that I might not pay her. This is the portfolio at risk amount, or the whole balance on the loans that are in arrears. In this case, if this were the only loan outstanding for the bank, the portfolio at risk ratio would be 500/500 = 100%. This is now the best method used by most banks for measuring the risk of loss of their portfolio. Not past due maturity. Of course to better understand this risk it should be “aged”. By this I mean breaking up the various loans by the age of their arrears. I will demonstrate this more in a minute.

Slide 7

Loan Loss Reserve Ratio

Definition:

$$\frac{\text{Loan Loss Reserve}}{\text{Value of Loans Outstanding}}$$

Data Required:

- Amount of allocated loan loss reserve on Balance Sheet
- Total amount of loans outstanding

Considerations:

- Should be based on an aging analysis of the portfolio at risk

Another important indicator is to analyze the loan loss reserve ratio, loan loss reserve/value of loans outstanding.

Slide 8

Example

Consider a Bank with following key data:

Number of loan accounts outstanding:	1,800
Number of accounts with an amount in arrears:	360
Value of loans outstanding:	19,760,000
Value of payments in arrears:	2,174,000
Balance of loans in arrears:	4,130,000
Average loan term:	4 months
Value of loans written off during the period:	700,000

Now let's do some simple calculations.
Portfolio in arrears = 2,174,000/19,760,000 = 11%
Portfolio at risk=4,130,000/19,760,000=21%

Slide 9

Example: Computation of Adequate Loan Loss Reserve

Aging Report	Outstanding Balance	Loan Loss Reserve Ratio	Loan Loss Reserve
Current	15,630,000	2%	312,600
1-7 days in arrears	2,100,000	2%	42,000
8-14 days in arrears	860,000	10%	86,000
15-30 days in arrears	730,000	25%	182,500
31-60 days in arrears	240,000	50%	120,000
Over 60 days in arrears	200,000	100%	200,000
TOTAL	**19,760,000**	**5%**	**943,100**

Now as I mentioned before it is important to make sure that loan loss reserves are adequate. Most commercial banks and regulated micro-finance institutions allocate loan loss reserves based on a percentage of the aging of the portfolio at risk. In the above example, all loans that are current or have missed payments of less than 7 days require a 2% loan loss reserve allocation, those from 8-14 days - 10%, from 15-30 days - 25%, from 31-60 days - 50%, and over 60 days - 100%. This is especially important for loans that have daily and weekly payments. For a bank with loans that have monthly or lump sum payments, those loans would have a different weighting in terms of providing for loan loss provisions.

Loan Delinquency

Case Studies

Handout #1

CASE STUDY – Zero Tolerance Against Past Due Loans

RURAL DEVELOPMENT BANK
(A)

It was late in the evening of June 25, 2000 when the manager of Rural Development Bank (RDB) was pondering on a problem that needed her immediate attention. Her 5-month old microfinance unit was faced with a loan delinquency situation. She did not expect anything like it, and was wondering in hindsight what could have been done in order to prevent it.

Background

In December 1999, the manager read about the success of microfinance in a newspaper article. Excited with the idea, she immediately hired two new field staff to conduct a study to evaluate its prospects. In particular, she wanted to know more about the characteristics and habits of microentrepreneurs in the small city where RDB's main office is located. The study was completed, and the results are summarized in Annex 1.

Within a week, she designed RDB's micro-loan product. (Annex 2 describes the micro-loan product features). She felt that because the loan amounts involved were small and the prospective borrowers relatively "unsophisticated" compared with the regular loan clients of the bank, the micro-loan product should be very simple (and thus would require less planning). New loans were quickly disbursed beginning January 2000.

The next four months' performance went far beyond expectations. The number of borrowers reached 501 by the end of May 2000. Moreover, financial reports from her staff (Annexes 3 and 4) indicated an increasing income trend. Soon, the microfinance unit would cover all expenses.

The micro-loan was a hit. So many people were interested that the office was usually full of loan applicants. This kept the field staff overwhelmed with work. They would often challenge each other on who could release the most loans each week. Nothing could go wrong – it seemed. By the end of April 2000, the past due rate[1] was only 5% (much lower than the 15% average of the bank).

On June 1, 2000 she decided to go out of the office and visit some of the borrowers. To her surprise, she discovered that some of them had not paid an amortization in the last 2 weeks. She immediately called a meeting with her staff and instructed them to estimate some figures that would give her an idea of the extent of the delinquency problem. When she saw the figures, she was terribly disappointed. Worse, nobody knew the exact balance of loans with missed payments.

Month	Total Number of Accounts	Number of Accounts with Missed Payments	Estimated Avg. Number of Days Payments are Missed
January 2000	5	0	0 days
February	45	7	7
March	121	24	14
April	272	68	21
May	501	251	28

One of the first things the manager did was to immediately call for an audit of the micro-loans receivable of RDB. The summary of audited figures is shown below:

		Jan/00	*Feb/00*	*Mar/00*	*Apr/00*	*May/00*
1	Number of borrowers	5	45	121	272	501
2	Value of loans outstanding	70,312	879, 906	3,202,031	7,545,821	18,846,349
3	Guarantee deposit	14,205	137,145	515,947	1,325,726	2,612,681
4	Amount of loans disbursed	130,000	1,260,000	3,944,000	8,142,000	15,725,000
5	Number of loans disbursed	5	45	116	236	425
6	Number of loans with missed payments	0	7	24	68	251
7	Amount past-due	-	105,469	386,719	1,320,518	3,905,723
8	Portfolio at risk	-	136,718	635,111	1,697,809	6,609,390
9	Amount of loans past maturity	-	5,280	48,799	230,936	923,359

[1] Past due rate is computed as the percentage of the amount of loans past maturity over the total loans outstanding.

In addition, the manager wanted to know how long the loans had been past due as she felt that it would be much easier to collect on a loan that is only 5 days overdue compared to one that is 2 months overdue. Her accountant prepared the following aging analysis for May 2000 and based on her assumptions, computed what she thought would be an adequate loan loss reserve:

AGED Portfolio at Risk May 2000	**Number of Loans in Arrears**	**Balance of Loans in Arrears**	**Loan Loss Reserve (%)**	**Loan Loss Reserve (P)**
1-7 days past due	117	2,780,873	10%	278,087
7-14 days past due	74	2,061,082	25%	515,271
15-30 days past due	43	1,244,786	50%	622,393
30-60 days past due	17	522,649	100%	522,649
TOTAL	251	6,609,390		1,938,400

Questions

1. Using the data above, compute the three key ratios for each month:

   a. **Portfolio in Arrears Ratio**
   b. **Portfolio At Risk Ratio**
   c. **Portfolio Past Maturity Ratio**

RATIO	***Jan/00***	***Feb/00***	***Mar/00***	***Apr/00***	***May/00***
Portfolio in Arrears					
Portfolio at Risk					
Portfolio Past Maturity					

d. Loan Loss Reserve ratio for May 2000

2. What do these ratios tell you?

3. Referring to Annex 4, do you think RDB has an adequate Loan Loss Reserve? If not, how should the manager increase it? And what effect would this have on the bank's profits?

ANNEX 1

Microfinance Unit
RURAL DEVELOPMENT BANK – A (RDB)

MICROENTREPRENEUR PROFILE[2]

The microentrepreneurs in the city are mostly females, between 30-49 years old.

They are engaged in small trading businesses such as sari-sari stores and market vending activities for the past three years or more. Their regular working capital needs range from $10,000 to $20,000 every month.

Most are borrowing from informal lenders, in the amounts of $7,500 to $15,000 payable in 30 days, without any collateral. Despite the high interest of 10% per month, they liked the accessibility of credit provided by the informal lenders, who visit them daily or weekly to collect payments.

When asked whether they would be interested in opening a savings account with the bank, almost everyone said yes. However, they felt that making frequent trips to the bank in order to make a deposit would be inconvenient. Furthermore, they did not know anybody who worked in the bank and would feel embarrassed to enter its premises.

[2] Based on results of a market survey conducted in December 1999.

ANNEX 2

RURAL DEVELOPMENT BANK
Loan Product Features

I. Target Borrowers

Micro-entrepreneurs, usually women, engaged in vending and other small business activities in the city.

II. Loan Amount, Term and Amortization

Loans are payable over 1, 2, 3, 4, 5, and 6 months, depending on the amount.

Loan Amount	Term (months)	Monthly Amortization			
		Principal	**Interest**	**Savings**	**Total**
20,000	1	20,000	400	200	20,600
40,000	2	20,000	800	200	21,000
60,000	3	20,000	1,200	200	21,400
80,000	4	20,000	1,600	200	21,800
100,000	5	20,000	2,000	200	22,200
120,000	6	20,000	2,400	200	22,600

III. Interest Rate

2.0% per month, flat rate, add-on.

IV. Service Fee

3.0% of the loan is deducted from loan proceeds as service charge.

V. Payment Frequency

Borrowers visit the bank to pay their monthly loan amortization.

VI. Guarantee Deposit

All borrowers are required to open a savings account upon loan release. The initial deposit equivalent to 5.0% of the loan amount is deducted from the loan proceeds. They must make additional deposits together with the weekly loan payments, as shown in the table above.

VII. Monitoring

Bank field staff conduct monthly visits to the client.

VIII. Security

Guarantee deposits can be assigned to the bank to cover loan payments in case of non-payment.

RURAL DEVELOPMENT BANK

ANNEX 3

Microfinanc

	Month 1	Month 2	Month 3	Month 4	Month 5
	Jan-00	Feb-00	Mar-00	Apr-00	May-00
Total # of Active Micro-depositors	5	45	121	272	501
Deposit Balance	14,203	137,145	515,948	1,325,727	2,612,682
Total # of Active Borrowers	5	45	121	272	501
Loan Portfolio Level	70,313	878,906	3,202,031	7,545,820	18,846,348
Number of Microfinance Staff	2	2	2	2	2
STATEMENTS OF INCOME AND EXPENSES					
Financial Income					
Interest Income on Loans	1,406	13,148	49,556	125,026	184,244
Service Fee on Loans	4,219	42,188	128,250	265,500	523,688
Penalty Fee on Loans	0	0	7,383	51,237	210,290
Interest Income on Central Bank Reserves	2	23	88	227	448
Total Financial Income	5,627	55,359	185,277	441,990	918,669
Financial Expense					
Interest on Deposits	30	315	1,361	3,837	8,205
Interest on Bills Payable	15,313	23,406	51,188	92,313	209,125
Total Financial Expense	15,342	23,722	52,548	96,149	217,330
Gross Financial Margin	(9,715)	31,638	132,729	345,841	701,339
Loan Loss Provision	(3,348)	(38,504)	(110,625)	(206,847)	(538,120)
Net Financial Margin	(13,063)	(6,867)	22,104	138,994	163,219
Operating Expenses					
Salaries and Benefits	66,938	66,938	66,938	66,938	66,938
Transportation	4,500	4,500	4,500	4,500	4,500
Communication	1,500	1,500	1,500	1,500	1,500
Gross Receipts Tax	281	2,767	8,890	19,526	35,397
Depreciation	0	20,625	20,625	20,625	20,625
PDIC	28	246	758	1,620	2,574
Other Expenses	13,125	13,125	18,750	18,750	18,750
Total Operating Expenses	86,372	109,700	121,960	133,458	150,283
Other Income	0	0	0	0	0
Net Income before Income Tax	(99,435)	(116,567)	(99,856)	5,535	12,936
Income from Grants	0	0	0	0	0
Net Income before Income Tax	(99,435)	(116,567)	(99,856)	5,535	12,936
Cumulative Net Income	(99,435)	(216,002)	(315,858)	(310,323)	(297,387)

RURAL DEVELOPMENT BANK
Microfinance Unit

ANNEX 4

STATEMENTS OF CONDITION	Month 1 Jan-00	Month 2 Feb-99	Month 3 Mar-99	Month 4 Apr-99	Month 5 May-99
Assets					
Cash					
Cash on Hand	330,727	295,267	411,724	468,863	476,642
Cash in Vault	284	2,743	10,319	26,515	52,254
Cash in Banks	710	6,857	25,797	66,286	130,634
BSP Reserves	426	4,114	15,478	39,772	78,380
Loans Receivable	70,313	878,906	3,202,031	7,545,820	18,846,348
Less: Loan Loss Reserve	(3,348)	(41,853)	(152,478)	(359,325)	(897,445)
Net Loans Receivable	66,964	837,054	3,049,554	7,186,496	17,948,903
Property and Equipment	843,750	843,750	843,750	843,750	843,750
Less: Accumulated Depreciation	0	(20,625)	(41,250)	(61,875)	(82,500)
Net Property and Equipment	843,750	823,125	802,500	781,875	761,250
Total Assets	1,242,862	1,969,160	4,315,372	8,569,807	19,448,063
Liabilities and Net Worth					
Liabilities					
Deposits					
Guarantee Deposit	14,203	137,145	515,948	1,325,727	2,612,682
Voluntary Deposit	0	0	0	0	0
Total Deposits	14,203	137,145	515,948	1,325,727	2,612,682
Gross Receipts Tax Payable	281	3,048	11,938	31,465	66,861
Bills Payable	1,312,500	2,006,250	4,059,375	7,410,938	16,828,125
Accrued Interest Payable	15,313	38,719	43,969	112,000	237,781
Income Tax Payable	0	0	0	0	0
Total Liabilities	1,342,297	2,185,161	4,631,230	8,880,129	19,745,450
Net Worth					
Shareholders Equity	0	0	0	0	0
Retained Surplus/(Deficit)					
Current Month	(99,435)	(116,567)	(99,856)	5,535	12,936
Cumulative	(99,435)	(216,002)	(315,858)	(310,323)	(297,387)
Total Net Worth	(99,435)	(216,002)	(315,858)	(310,323)	(297,387)
Total Liabilities and Net Worth	1,242,862	1,969,160	4,315,372	8,569,807	19,448,063

Case Study 2

CASE STUDY – Zero Tolerance Against Past Due Loans

RURAL DEVELOPMENT BANK
(B)

By July 2000, the delinquency problems at RDB just seemed to be getting worse. More and more clients were applying for loans leaving little time for the staff to do anything about the problem clients. The manager was at her wits' end. As members of her board, she has asked you to give her advice on what her next steps should be. Prior to that, she would like your input on what happened.

1. What do you think caused the delinquency problem of RDB?

2. What do you think could have been done to prevent the delinquency problem?

3. If you were the manager of RDB, what steps would you now undertake to address the delinquency problem?

A. What caused RDB's delinquency problem?

1. Poor product design

- Loan sizes too large
- Installment payments too large (monthly, instead of daily or weekly)
- Borrowers asked to come to the bank – something which they are reluctant to do
- No incentives for on-time payments and penalty for delayed payments

2. Poor MIS

- Nobody knows the extent of the delinquency problem

3. Poor management

- Bank manager could be quite busy with the bank's regular activities. She only had time to visit clients on the 6th month
- Focus apparently was on quantity, not quality of the loan accounts

4. Overworked staff

B. What could have been done to prevent the delinquency problem?

1. More time should have been spent analyzing the results of the market survey (i.e., knowing the needs and preferences of the target clients) and, subsequently in designing the loan product

2. A full-time microfinance credit supervisor should have been assigned to oversee the day-to-day activities of the credit officers (especially in reviewing the loans recommended for approval by the credit officers)

3. More prudent weekly or monthly client outreach targets should have been set for each credit officer

4. The MIS should have been designed and installed in place

C. What steps should now be undertaken to address the delinquency problem?

1. Stop lending to new clients and prioritize the collection of delinquent loans

2. Conduct an evaluation of the delinquent accounts to determine the causes and plan strategies on a case-to-case basis

3. Review the design of the loan product

    - Loan sizes
    - Amortization schedule
    - Loan collection policy
    - Client incentives and penalties

4. Introduce a more rigorous client selection method, including cash flow analysis

5. Assign a full-time credit supervisor

6. Develop & install an appropriate MIS

7. Design and introduce a staff incentive scheme based on workload and on-time repayments

8. Hire and train additional credit staff

Controlling Delinquency

Slide 1

CONTROLLING
DELINQUENCY

Slide 2

WHAT CAUSES DELINQUENCY?

Uncontrollable Factors

a. Natural disasters
 -fires, typhoons, flood, drought

b. Government policies
 -crackdown on street vendors
 -banning/phase-out of tricycles in major streets
 -relocation of the public market leading to dislocation of many micro entrepreneurs
 -new taxes that double the price of certain inputs or commodities

c. Illness or death in the family
d. Slow down in the growth of the local economy

But this risks can be mitigated by:
-Emergency grace periods
-Restructuring & refinancing
-Emergency or insurance funds
-Smaller loan sizes & longer terms

Slide 3

WHAT CAUSES DELINQUENCY?

Controllable Factors

"Traditional View"

Borrower fails to pay because of misuse of funds, which consequently renders him unable to repay

"New View"

Widespread delinquency is more frequently a reflection of the borrowers' unwillingness to repay.

Borrower behavior (unwillingness to repay) is usually caused by:

- *the perception of not needing to repay (experience with other credit programs)*
- *cultural*

Slide 4

CONTROLLING DELINQUENCY:
THREE CRITICAL AREAS

1. Bank image and philosophy
2. Credit Methodology
3. Management Information System

Slide 5

Bank Image and Philosophy

- The bank must view its microfinance activity not as a social obligation (helping the poor), but as a profitable business.
- The bank can still project an image of being pro-poor but the borrower’s responsibility to pay back on time must be made clear.
- Create an institutional culture in which late payments are simply unacceptable (*Zero Tolerance to Loan Delinquency*). This culture should be ingrained in the entire staff, and consequently in each borrower

Slide 6

Credit Methodology

- Clients must value the credit service.
- Select clients based on thorough CI/BI
- Use cash flow analysis to determine loan size and terms. Avoid automatic step-up lending
- Provide both financial and non-financial incentives for clients to pay back on time and disincentives for late payment
- Require a physical guarantee (household assets)
- Make sure that the co-makers are willing and able to assume loan payments if the loan becomes delinquent
- Develop delinquency follow-up procedures. List the steps that should be taken when a loan becomes delinquent.

Slide 7

Credit Methodology (cont.)

- Develop prudent loan-loss reserve and write-off policies that prepare the bank for such write-offs
- Employ AOs who are intimately familiar with the community they are working in
- Make the concerned AOs responsible for the collection of delinquent accounts in their respective portfolios
- Require AOs to immediately report and follow up on accounts with missed payments
- Provide performance incentives for AOs that includes on-time repayment

Slide 8

Management Information Systems

A combination of good and timely reports enables a field worker to manage hundreds of borrowers and minimize delinquency by:

- Planning a geographic route that enables him/her to visit a maximum number of borrowers in a given period
- Visiting borrowers quickly after a payment becomes past due to determine the problem and help solve it
- Processing repeat loans in a timely fashion for good borrowers to encourage continued on-time repayment
- Planning different strategies for different delinquent borrowers, depending upon their credit histories and how far behind they are on their payments

Slide 9

Management Information Systems

A good information system also provides managers with tools for analysis

- Reports that classify delinquent loans by age enable the manager and the account officers to formulate an appropriate plan of action
- By looking at trends, the manager would be able to know if delinquency is improving or getting worse, and the probable reasons for this.
- Variables to be examined in trend analysis:

  -Age of arrears
  -Account Officer performance
  -Geographical location of borrower
  -Size of loan
  -Business activity
  -Gender
  -Number of loans availed of

Slide 10

Delinquency Management Procedure

# Days Payment Is Missed	Delinquency Signal No.	Steps to Take
1 day	1	• AO verifies reason for missed payment • AO demands payment
3 days	2	• AO warns borrower of adverse consequencies for continued non-payment (penalty, negative credit rating)
7 days	3	• First warning letter sent • Penalty is applied • Co-borrower & Co-Makers informed
14 days	4	• Second warning letter sent • AO Supervisor/Manager visits principal borrowers & co-makers • AO Supervisor/Manager warns principal borrowers & co-makers of possible credit access cut-off if loan payments are not updated
21 days	5	• Third & final warning letter sent • Borrower required to fully repay the loan • Principal borrowers and co-makers warned that bank will take legal action if loan is not fully repaid within one week
30 days	6	• Bank takes legal action -Barangay court/Lupon/Municipal court -Legal adviser

Slide 11

WHEN TO RESTRUCTURE LOANS

- Restructuring should only be done in extreme cases, such as when the reason for missed payments is due to factors beyond the borrower's control
- The borrower is willing to pay, but could not, given his/her predicament
- There is a strong possibility that the borrower will be able to repay his/her loan, if the loan will be restructured
- The decision to restructure a delinquent loan should be made within the first two weeks a borrower starts missing his/her payments.
- Restructuring should only de done once for each client.
- The term of the restructured loan should not exceed the maximum term of the loan product

Slide 12

WHEN TO WRITE-OFF LOANS

- Loans that have been past due for six months and are justified to be uncollectible maybe written off
- A loan is deemed uncollectible, when:

  a) the borrower and the guarantors cannot be located despite diligent search

  b) the principal borrowers are deceased and the surviving heirs, if any, disclaim knowledge of the obligation with the bank and they cannot be held liable thereof

  c) the collateral(s) mortgaged to the bank cannot be identified or located, and the borrower or guarantor has no leviable properties and other sources of repayment
- Write-off of loans should be subject to the approval of the bank's Board of Directors

Slide 13

REMEMBER:

Constant follow-up is one of the keys to preventing and controlling delinquency.