CREDIT POLICY MEASURES AND PERFORMANCE OF MICROFINANCE BANKS

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Abstract
The purpose of this study was to examine the effect of credit policy measures and their influence on the performance of microfinance Banks. The objectives were; to investigate the effect of credit worthiness and the approval of credit limits on performance of microfinance bank, to examine the impact of control credit accounts and the maintenance of good relation on performance of microfinance bank and to investigate the level of customer's satisfaction on credit polices of microfinance bank. Data were sourced from primary using questionnaire instrument. Regression analysis techniques was used in this study, to establish a relationship between dependent and independent variables. The findings revealed thus; credit worthiness and approval of credit limit to customers in microfinance bank, customers have derived significant satisfaction from credit policy of microfinance banks right from inception and microfinance bank do maintain good relationship with credit customers on control credit account. The study recommended that microfinance banks interest rate should be reviewed to allow more customers being attracted to applying for credit facilities.

Introduction

Credit is an indispensable catalyst in financing the development of banks in Nigeria. The essence of these banks was to provide banking services in all ramifications at microfinance level to the inhabitant of communities (Nzotta, 2004). In 2007, the concept of community banking was replaced with microfinance institutions, credit helps in producing, distribution, selling, consumption and expansion, credit could mean a collapse due to over buying, over expanding or expansion or over selling. The objective of credit is to lend with the purpose of increasing profits and sales. Therefore its policy in business is a blue print to managing by measurement and bench marks. Credit policy begins with an understanding of the financial exposure that your business can endure and the amount of your working capital that you could be willing to risk or the investment to invest in your customers. According to Nzotta (2006) report microfinance has power for over 65 percent of the Nigerian population that lacked access to the formal financial system. This banks give loans to their customers without any collateral for the fact that the poor do not own assets usually, pledge as collateral. This will help indeed to bridge a huge gap in the provision of financial services to a large proportion of the active but poor and low income groups. According to Jombo (2003) community banking was introduced in the 1990 national budget to provide grassroots financial services to any defined local community whether in the urban or rural areas. This first of bank "Alhari community bank in Kaduna was commissioned on 31st December, 1990 community bank Degree No. 46 of 1992 and this supervision was the National Board of Community Bank (NBCB) before it was scrapped while the overall supervision is the Central Bank of Nigeria (CBN). The activities and operations of community banks are regulated by the banks and other financial institutions. Decree (BOFID) 1991, community bank Decree No. 46 of 1992, the companies and Allied Maters Decree 1990 and the NBCB operational guidelines. For microfinance banks to brazen up to better banking services that will positively support the economic polices of the federal and state government. There is a current wide belief that microfinance is one of the powerful development tools with which to eradicate poverty through the provision of timely affordable and dependable financial services to the economically achieve poor and low income households.

Throughout history, credit has been a key factor for the creation of wealth since loans to small business and individual entrepreneur could foster self-reliance and community wide economic development. Indeed several microfinance scholars such as Nzotta (2005) and Jhingan(1999) have

laid the claim that the industry is growing at a rate of more than 25 percent per year in the last decade, but only a small fraction of the demand for micro finances services has been met, as domestic capital markets have been in accessible to MFIS, while international donors that contributed collectively or individually cannot supply all the resources needed for scaling up services and outreach (Hadiza, 2005). The study sought to achieve the following objectives;

1. To investigate the effect of credit worthiness and the approval of credit limits on performance of microfinance bank
2. To examine the impact of control credit accounts and the maintenance of good relation on performance of microfinance bank.
3. To investigate the level of customers satisfaction on credit policies of microfinance bank

Literature Review and Theoretical Framework

The credit rationing theory, propounded by Stiglitz and Weiss (1981), provides a framework for analyzing financial market inefficiencies. It asserts that, information asymmetry is the main cause of financial market malfunctioning in developing countries. Bank that advance loans to SME are not only interested in the interest they receive on loans, but also the risks of such loans. Also, the interest banks charge on loans that have the tendency to affect the risks of a pool of loans by either sorting potential borrowers or affecting the behavior of borrowers. The end result of these two designed problems are that banks have to resort to various screening means to identify potential borrowers who are more likely to pay back their loans; since the expected return on such loans depends crucially on the probability of repayment. One of the methods of screening suggested by Stiglitz and Weiss is the interest rate that an individual is willing to pay. This is because, given the efficient financial markets hypothesis, individuals who are willing to pay high interest rates may on the average not pay back the loans collected and banks are mostly discouraged to give loans to such borrowers. On the other hand, low risk borrower faced with high interest rates, all things being equal will be expecting negative returns and hence will not go for such loans. Therefore, in our world today where people can easily get all the information they need, banks could precisely predict all actions by borrowers but may not be able to control such actions. The terms of loan credit are thus designed (banks) in a manner that induces borrowers to take actions in the interest of banks, and that also attracts low risk borrowers. For both reasons, the expected returns of banks increase less rapidly than the interest rate and beyond a certain point, actually declines. The moral hazard problem, on the other hand, is that a risks-neutral firm will prefer projects with low probability of bankruptcy and hence make lower expected returns.

Credit policy measures

Every bank puts in place a credit policies to guide its lending decisions, taking into consideration its overall corporate mission and objectives. Conceptually, a bank’s corporate objectives influence its overall banking operations including issues like: Liquidity management , Profitability posture and earning capacity, Bank portfolio management, Service delivery and level of efficiency, Deposit mix and structure ,Credit management and Capital adequacy, etc. Credit management is the most important aspect of banking operations outside liquidity considerations, as it influences and ensures the survival and safety of a bank. Credit policies are thus the most important aspect of the various operational policies of a bank. The policies provides a framework for the entire credit management process. The basic reason for policies is to ensure operational consistency and adherence to uniform and sound practices. A sound policies contributes to bank’s success by supporting prompt and good credit decisions. According to Robert (1991), the scope of lending (credit) policies should include: who receives the credit; who grants it (and how); the pricing of the credit; the amount of credit and the organizational structure for its distribution. Other issues like what kind of credit and under what circumstances they are granted, also come into this purview of credit policies making. The above definition by Bench(2009) seeks to specify the scope of credit policies. However, the definition could be stretched further by pointing out the fact that credit policies influences and affect the

administration and management of credits. Credit policies are usually documented by banks in the form of credit manuals. The manuals specify the course of action, procedures and guides to sound lending. A properly articulated manual would usually consolidate and update all lending policies, instructions, procedures and any relevant correspondence on credit matters and administration that would be evolved by top management from time to time, based on new exigencies, new developments in the industry, changes in environmental factors and other changes evolved by the monetary authorities as the need arises.

The absence of a properly articulated, formally written policies document coupled with the failure of credit officers, managers and directors to monitor the implementation and administration of bank credits, are critical factors leading to unsuccessful bank lending or non-performing exposures and credits. It must be emphasized here that putting sound policies into practices calls for the establishment of an effective organization and the adoption of appropriate procedures. However, most banks do not clearly spelt out and formalize policies framework, hence credit decision making is adhoc and thus cumbersome, leading to loan losses and impairment of capital adequacy.

The need for microfinance banks

Miller (1995) describes microfinance as the paradox of saving mobilization. Because this is a world in which many poor and low income households, individuals have permanent access to an appropriate range of high quality financial services to assist them in their subsistence and small businesses. The duty of microfinance banks is to provide microfinance to those who cannot access universal or development banks to raise funds. African development bank (2008) asserts that about 90 percent of 180, million poor households over the world. Finance their need from microfinance banks. The World Bank estimates that there are over 700 microfinance institution serving some 16 million poor people in the developing world. Saving mobilization by microfinance institution in selected communities or countries: The African experience shows that the institutions have been very successful. It is even looked in Kenya as the most effective way of providing financial services. This takes us to a big question of the need for microfinance banks. The foregoing has made us to see that in the economic main stream especially in the developing world, that microfinance bank is usually readily available to touch most of our poor who would otherwise have no access to funds in ordre to finance their small businesses. In Nigeria, before now we had seen the difficulty of commercial or development bank in extending credit facilities to the rural poor communities. This prompted the 1987 decree 4 on (DFRRI) Directorate of food Roads and Rural Infrastructures to submit a memorandum in 1989 on the need to establish community bank as it was then called, it was in the light of this in 1990 budget that President Ibrahim Babangida announced the introduction of Community Bank Programme. The first branch of community banks in Nigeria was launched and commissioned by Gen. Ibrahim Babangida in Kaduna named Alhari Community Bank on December 31, 1990, reported the National Board and Community Bank (NBCB) annuals, a publications of the Board Several of this banks have spring up since then. The government helped to incorporate and license those, train staff and even assist them with matching loan to enable them catch up from their infancy.

Nzenwa (2007) is of the opinion that microfinance bank was introduced to give a new face to the credit system in our financial system which has in the long run drawn posture impact and strengthen growth and development in the economy. As you can see, the institution has metamorphosed from community bank to microfinance bank on nomenclature as well as from N5,000,000.00 is referred to put basic infrastructure in place leaving zero or a negative balance for banking operation. The bank is expected to engage in aggressive mobilization of savings from micro depositor to share up their operating funds. The requirement for a unit's microfinance bank is N20 million share capital. A state coverage microfinance bank that will operate multiple branches which is expected to have N1.0 billion sufficient to operate a full branch in at least 213 of the local government areas in the state. The experience of other countries sheds light in the level of capitalization required for microfinance banks. In most countries, the level of capitalization depends on the geographic

coverage of this bank. For some the population and volume of business of the area further determine the level of capitalization, this was used as the parameter in arriving at the recapitalization levels for the two categories of microfinance bank in the country.

Credit policy measures used by Microfinance Banks

Microfinance institutions use the 5c's model of credit to evaluate a customer as a potential borrower (Abedi, 2000). The 5cs help microfinance to increase loan performance, as they get to know their customers better. These 5c's are character, capacity, collateral, capital and condition. The factors that influence a client can be categorized into personal, cultural, social and economic factors. The physiological factor is based on a man's inner worth rather than on his tangible evidences of accomplishment. Microfinance considers this factor by observing and learning about the individual. In most cases, it is not considered on first application of credit by an applicant from the second time (Weston and Eugene, 1996).

The conditions focus on the borrower's vulnerability.

a) Credit terms
   This refers to the conditions under which a Microfinance advances credit to its customers. The credit terms will specify the credit period and interest rates. Credit period refers to the period of time in which the credit is granted. The length of the credit period is influenced by collateral value, credit risk, the size of the account and market competition (Ross, 20008).
b) Credit risk control
   Credit risk is an investor's risk of loss arising from a borrower who does not make payments as promised. Such an event is called a default.
c) Collection policy
   These are various policies that an organization should put in place to ensure that credit management is done effectively. One of these policies is a collection policy which is needed because all customers do not pay the firm bills on time. Some customers are slow payers while some are non-payers. The collection effort should therefore aim at accelerating collections from slow payers and reducing bad debt losses.
d) Economic cycles
   The term "economic cycle" refers to economy-wide fluctuations in production or economic activity over several months or years. These fluctuations according to Pandey (2008) occur around a long term growth trend and typically involve shifts over time between periods of relatively rapid economic growth.

Research methodology

This study was carried out in Calabar, Cross River State. The population covered all the microfinance bank operators. Since the population of microfinance bank operators is unknown, the top man's rank formula was used to determine the population.

Top man's rank formula:

$$n = \frac{Z^2(Pq)}{e^2}$$

Where;

n = Sample size
P = Probability of success
q = Probability of failure
e = Tolerable error
Z = Confidence level

Where;

Z = 95percent

$P = 80$percent
$q = 20$percent
$e = 5$percent

Applying the formula:

$$\frac{(1.96)^2(0.8)(0.2)}{0.05^2}$$

$$= \frac{3.8416 \times 0.8 \times 0.2}{0.0025}$$

$$= \frac{0.614656}{0.0025}$$

$$N = 246.8 \cong 247$$

Simple random sampling technique is used to elicit sample for this study. The selection of the sample was carried out thus, the researcher wrote top management, middle management and lower management on eleven different cards and put them in three boxes, each box contains eleven cards. The researcher blindly picked one card from this stratum. The already picked cards were replaced and thoroughly mixed before the exercise was repeated until eleven cards were picked from each box so as to ensure that equal numbers of subjects are selected without bias. A combination of primary and secondary data was used in gathering information for the study. Since this study involved a cross-section survey design, the main instruments used in gathering the data were questionnaire and interview. The instrument was measured using the five point likert scale**:** Strongly agree (SA) Agree (A), Undecided (U) Disagree (D) Strongly Disagree (SD) **.** Regression analysis technique was used in this study to establish a relationship between dependent variable and independent variables.

MPER = f (CW, CA, CS)

Where

MPER = Microfinance Performance
CW = Credit Worthiness
CA = Credit Accounts
CS = Customers satisfaction
MPER = X0 + X1CW + X2CA + X3CS + e

Findings

The following findings were ;

(1) Credit worthiness and approval of credit limit to customers in microfinance bank is healthy.
(2) Customers have derived significant satisfaction from credit policy of microfinance bank right from its inception.
(3) Microfinance bank do maintain good relationship with credit customers on control credit account.

Conclusion and Recommendations

Besides, customers have derived significant satisfaction from credit policy of microfinance bank right from the establishment of microfinance bank. Again, microfinance bank do maintain good relationship with credit customers on control credit account. Indeed, microfinance, banks credit policy and customer satisfaction have been favorable in the provision of credit to customers. It is recommended that Microfinance banks interest rate should be reviewed to allow more customers being attracted to applying for credit facilities, Microfinance banks show review their lending period so as to expand the credit period and government should continue to strengthen the capital base of

microfinance bank to enable them have the needed capital strength to meet credit obligations by customers.

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