HOW TO AVOID OVER INDEBTEDNESS AMONG MICRO FINANCE CLIENTS

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- Reasons for over indebtedness
- Implications and Risks to MFIs and Clients
- Strategies to avoid over indebtedness
INTRODUCTION-OVER INDEBTEDNESS

- Unable to meet the commitments associated with the contractual financial commitments & recurring expenses

- If the income is not sufficient for serving debt on time (after accounting for the cost of living) over a period’
A state in which a borrower's debt service obligations are so high that they require the borrower to make sacrifices in her/his basic quality of life.

Therefore, MFI should take reasonable steps to ensure that credit will be granted only if the client have an adequate capacity to repay.
Thereby, loan should not put the client at significant risk over indebtedness.

Responsibility for avoiding over indebtedness rest with both MFI and the Client.

Client – Prudent decisions and judging their repayment capacity.
INTRODUCTION-OVER INDEBTEDNESS cont.

- MFI – Carefully evaluating the Client’s repayments capacity.

- MFI should consider the over-Indebtedness challenge as “Risk for the Client means Risk for the Institution”.
INTRODUCTION-OVER INDEBTEDNESS cont.

MFI should integrate the above philosophy into their organizational culture and should create values of excellent professional services for the clients' satisfaction.
RESONS FOR OVER INDEBTEDNESS (MFI’S)

- Filed officers follow the fast track method and ignore the standard process of Center/CBO formation etc.
- Inadequate evaluation of the Client’s borrowing capacities current and future.
- The loan (size) is under or over the requirement of the client.
RESONS FOR OVER INDEBTEDNESS (MFI’S) cont.

- MFI’s are target driven - Credit targets given for Filed Officers, performances are measured and incentives are paid.
- Lack of Credit Bureaus for MFI & information sharing between MF providers, prevents MFI being able to verify the existing indebtedness of prospective clients.
RESONS FOR OVER INDEBTEDNESS (MFI’S) cont.

- High Industry rivalry and too much focus on market penetration strategy.
- MF industry is becoming popular, attractive, potential growth opportunities and limited entry barriers.
RESONS FOR OVER INDEBTEDNESS (MFI’S) cont.

- Unfair competitive tactics among MFI’s and frequent employee cross over between MFI’s

- Business plans lack competitive strategies
RESONS FOR OVER INDEBTEDNESS (CLIENT)

- Lack of financial literacy and they don’t have skills to manage their finances and make informed decisions
- Lack of business knowledge and over confidence.
- Lack of transparency and honesty
- Debt is available without material security.
RESONS FOR OVER INDEBTEDNESS (CLIENT) cont.

- Excessive borrowing from multiple MFI
- To settle another loan or repay overdue installments
- Unpredictable events or vulnerability such as sickness or death of family member
- Loan amount < Client requirement
IMPLICATIONS / RISK - MFI

• Recovery issues and associated cost - legal, manpower and opportunity etc

• High loan default rates

• Opportunity cost of management
IMPLICATIONS / RISK – MFI cont.

- High PAR and adverse effect on investor (debt/equity) confidence
- Regulatory issues and concerns
- High loan written off’s and effect on P&L and value of the MFI
IMPLICATIONS / RISK - CLIENT

• Cannot service the debts regularly and face social and financial exclusion.
• Borrow more and more to service the loan installments and default charges (high rate if it is from local money lender).
• Inability to meet unexpected expenses such as medical, funeral etc.
IMPLICATIONS / RISK - CLIENT cont.

- High commitment for installment payments which push the household below the poverty-threshold
- Burden on the other monthly commitments such as house rent, utility bills etc and payment capacity will be considered as “very difficult”
- Family breakdown and life events are at risk lead to frustration, stress and depression.
STRATEGIES TO AVOID OVER INDEBTEDNESS

Continues MFI’s commitment is required to detect, prevent and correct the over indebtedness among Clients.

Detect

• Irregular loan repayments & frequent defaults
• Bad attendance at Center/CBO
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

Prevent

• Clients Loyalty as means to prevent over indebtedness – Develop and deliver tanning on Positive thinking, attitudes, motivation, self discipline, creativity and honesty etc. before the evaluation of credit as the MFI cannot control Competitors actions.
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

• Focus on market development strategies, encourage ethical marketing and adhere to standards and best practices in the industry for Center/CBO formation and build a robust system that should function through out the lending process that would satisfy all the stake holders.
CONTINUES training of Filed staff for responsible lending, disclose all necessary information's to clients, in respect of interest rate, default charges, repayment period, or any hidden cost and be honest.

Make credit evaluation (extensive) of clients ability to service the loan. Loan application process needs analysis, field visits, cash flow & income projection etc.
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

- Financial Literacy by client tanning – a way of enabling client awareness of risk and opportunities of debt, make informed decisions, record I &E, budgeting etc. (provide education to future clients (school leavers) to ensure that young females receive training before they become active client of MFI.)
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

- Encourage Savings and Insurance to protect against unpredictable events and future changes in situations.
- Encourage Product development strategies, diversified product offerings, better alignments of products to clients needs prevent over indebtedness by multiple borrowings.
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

• Credit reporting mechanism, Bureau or credit data sharing systems between MFI’s

Correct

• Responsible arrears management, take proactive approach to avoid arrears & multiple borrowing to settle the over due installments.
STRATEGIES TO AVOID OVER INDEBTEDNESS cont.

- Assist clients who are seriously over indebted, rehabilitate them by rescheduling loans for further period, debt advice, counseling service, avoid further default by providing guidance on fund management (I & E) and budgeting.
THANK YOU

“While business is a game of numbers, real achievement is measured in infinite emotional wealth's: friendship, usefulness helping, learning, or, said another way, the one who dies with the most joys wins”.

- Dale Dauten