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# PRACTICAL CHALLENGES OF RURAL AND MICRO FINANCE INSTITUTIONS IN GHANA IMPLICATION FOR DEVELOPMENT AND PERFORMANCE OF THE INDUSTRY THE CASE STUDY OF AVENOR RURAL BANK

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**Keywords**

Bank of Ghana, Customers, Micro credit, Rural and Community Banks, Performance, Rural Bank and Micro Finance Institution

**Abstract**

This article soughttoassesshowmicrocreditismanagedinAvenorRuralBank.Italso examinedwhethertheperformanceof micro loanwasinline withBankofGhanabenchmark. Additionally,itexaminedthecriteriausedinidentifyingcreditworthyclients,theeffectivenessof the loan disbursementprocedures,theextenttowhich the bankseducateandsupervisethecustomers andproblemsencounteredinrecoveringbankloansgranted.

## 1 Introduction

The allocationof resourcesoverthe pastyearshasbeenconcentratedinthemajorcitiesandurban centerstotheneglectofmostruralareas.Hence,thepoverty situationinruralGhanaisserious.This hasfuelledtherateofrural-urbanmigrationwithitsassociatedproblems.Thepoverty situationin Ghana hascaughttheattentionofsuccessivegovernmentsinGhana aswellasnon-governmental organizations(NGOs)toresource theruralfolks.Ghana hasovertheyearsusedruralbanksasa conduittochannelaidfunds todefinedtargets.Someoftheschemesare RuralEnterpriseProject (REP), SmallHolderCreditInput,Supply andMarketing Project(SCIMP),LandConservationand RehabilitationProject(LACOSERP),Community InvestmentFund(CIF),Foodand Agriculture BudgetarySupport (FABS) etc.

BeforetheestablishmentofthefirstruralbankinGhanain1976theexistingformalbankingsystem–ownedandmanagedby expatriates- wasusually locatedinbigbuildingsonthehighstreetsofthe majortowns which essentiallycatered for theneeds of thegovernment, thebig external tradingfirms, someliteratewealthyGhanaiansandsomeseniorCivilservants(Asiedu-Mante,2011).Accordingto Asiedu–Mantemajority ofGhanaian,non-literateandlessaffluent,fearedtostepfootinthose building and had virtually no access to institutional credit and other banking facilities. Most Ghanaianswere atthe mercyof moneylenderswho chargesoutrageous interest rates.In thehistoryof microfinance,MicrofinanceInstitutionshavebeenthefirsttoidentify thevastun-serveddemandfor microcreditindevelopingcountries, developmethodologiesfordelivering smallloans,and begin creditprograms forthe poor and recovering (Delfiner et al 2007).

RuralBankinginGhanatakesitsoriginfromtheearly 1970s.Priortothatperiod,themainoperators inthe ruralfinancial marketcomprised branchesof commercialbanks,creditunionsaswellasother entitiesintheinformalsectorsuchasmoneylenders,tradersandsusu collectors(Asiedu-Mante2011).Thetraditionalcommercialbanksfailedtobeattractedtotheruralsectorbecausethey believedthattheruralfolksweremostlyofthelow-incomegroup,andwerescatteredoverawide andalmostinaccessible areas.Thiscoupled withthe factthatsuch ruralpoor couldnotprovide the requiredcollateralsecuritynecessarytosupporteffectivecommercialfinancialoperations,servedas a disincentive tothe commercialbanks. Since1976,the number of registeredruralbanksinthe countryhasgrown to 135(BOG, 2011).

AvenorRuralBankwasestablishedin1982.Thiswasinresponsetotheneedandtheconcernto makeinstitutionalcreditandotherformalfinancialandbankingserviceseasilyavailabletothe people ofAkatsiand itsenvirons.IthasitsheadquartersatAkatsiintheAkatsi SouthDistrictinthe VoltaRegion.Themainpurposeofitsinceptionwastohelpinculcatethehabitofsavingintothe ruralfolkwithinitscatchmentareasandalleviateruralpoverty bygrantingcredittothepeople. Today,thebankhasfive(5) agenciesintheVoltaRegionof Ghana.Theoperationsof thebankare mainly focusedonincomegeneratingactivitiesby advancingloanstoitscustomers,especially, women to help them startbusinesses on their own.

Inanarticle titled–RuralBankinGhana collapsingAmpah(2010) indicated thatruralbanksin Ghanaaregrappling withhugechallengesinmanaging theirloanlossreservesduetobadloansand poormanagementsystemsappliedby thebanks.Asaresult,majority oftheseRuralandCommunity Bankshavebeenrenderedinsolventandcouldsoonfoldupifausterity measureswerenottakento reversethetrend.Thearticleindicatedthatthepoorperformance ofRuralandCommunity Banks stemmedfrombothunfavorableoperating environmentandcapacity constraints.Ruralbankshave unfavorableenvironmenttomobilize scatteredruralincomesata highcostintosavings,andlendto thepeoplewithvirtuallynocollateraltosupportsuchcredits.Itistherefore,imperativetoputin placelegitimate policiesand procedures that willensure amongother things that:

I. Theproperauthoritiesgrant credit;
II. Creditgoes to therightpeople;
III. Creditis granted forproductive activities;
IV. The appropriate sizeof creditisgranted;
V. Creditis used forthe purposeforwhich itwasgranted;
VI. Creditgranted is fullyrecovered;
VII. There isadequateflowofmanagementinformationwithintheorganizationtomonitoreachcredit activity.

## 2 Literature Review

### 2.1 DefinitionofMicro credit

Microcreditisrecognizedasthe practiceofoffering small,collateral–freeloanstomembersof cooperativeswhootherwisewouldnothave accesstothecapitalnecessary tobeginsmallbusiness (Hossain,2002). AccordingtoYunus(1998),creditshouldnotbeseenasaluxury fortherich, itshouldbeanopportunityforall:–Justlikefoodis;creditisahumanright‖. It‘snotpeoplewho aren‘tcredit-worthy.Its banksthose aren‘tpeople-worthy‘.

### 2.2 Models ofMicrofinance

Microfinance since its inception has evolved in different parts of the world, where the poor experiencedifferentneeds,political,sanitaryandenvironmentalconcerns.VariousEntitieshave beensetuptoprovidesupporttothebooming industry,considering justIndiagrowing at28%to47% from2003to2007inloandisbursements. Thereare2generalformsofmicrofinancemodels.Thefirstand foremostistheIndianmicrofinancemodelthatwasstartedby Prof.MuhammadYunus,winnerof Nobel Peace

Prize 2006.The nextistheLatinAmericanModelthatemergeddue tothe variationin demographics oftheLatin Americancompared to Asian regions.

### 2.3 SourceofFinancefor MicrofinanceInstitution

Microenterprisesgenerally covertheirinitialcapitalneedswiththeentrepreneur'sownfinancial meansandshort-termcreditsfrombanksandsuppliers.Asaconsequencethey havehighdebtequity gearingratioandlowliquidity (OECD,2003).Equity isprovidedby personalmeansorby contributions of informal financefrom friendsandfamily.Seedandearly stageVenture Capitalfinancing isavailableonly forinnovativestart-upswithhighgrowthpotential.Inaddition many entrepreneursdonotseeksuchinvestmentbecauseitmay entaila dilutionoftheirownership. Thevariousformsofdebtfinanceremainthemainsourceofexternalfinanceformicrofinance (Berger&Udell, 1998).

### 2.4 Creditmanagement

CreditManagementreferstotheefficientblendofthefourmajorcreditpolicy variablestoensure promptcollectionof loansgranted tocustomersandatthesame time boosttheir confidence inand loyaltytothebank(VanHorne,1995).

I. Assessment of the creditculture,
II. Portfolio objectives and risk tolerancelimits,
III. Management information systems,
IV. Portfolio segmentationand risk diversification objectives,
V. Analysisof loans originated byother lenders,
VI. Aggregatepolicyandunderwritingexception systems,
VII. Stress testingportfolios,
VIII. Independentand effective control functions,
IX. Analysisof portfolio risk/reward trade-offs

### 2.5 Principle oflending

Gaurav (2010) identified general principles of good lending which everybanker follows when appraisingan advanceproposal as follows:

I. **Safety**
II. Liquidity
III. Purpose:
IV. Profitability
V. Security
VI. Spread
VII. NationalInterest, Suitability

### 2.6 Credit appraisaltechniques

Guidelinesfor CommercialBanksfor PakistanBanksindicatedBanksmustoperatewithina sound andwell-definedcriteriafornewcreditsaswellastheexpansionofexistingcredits.Creditsshould beextendedwithinthetargetmarketsandlendingstrategy oftheinstitution.Beforeallowingacredit facility,thebankmustmake anassessmentofriskprofileofthecustomer/transaction.Thismay include:

*a)*Creditassessment oftheborrower's industry, and macro-economicfactors.

*b)*Thepurpose of creditand sourceof repayment.

*c)*Thetrack record /repayment historyof borrower.

*d)*Assess/evaluatethe repayment capacityoftheborrower.

*e)*TheProposed terms and conditions and covenants.

*f)*Adequacyand enforceabilityof collaterals.

*g)*Approval from appropriate authority

**2.7 Loan policy**

Guidelinesfor CommercialBanksfor PakistanBanksindicated theseniormanagementof the bank shoulddevelopandestablishcreditpoliciesandcreditadministrationproceduresasapartof overall credit riskmanagement frameworkandget thoseapprovedfrom board. Such policiesand procedures shallprovideguidancetothestaffonvarioustypesoflending includingcorporate,SME,consumer, agriculture,etc. At minimumthe policyshould include:

*a)*Detailed andformalized creditevaluation/appraisal process.

*b)*Creditapprovalauthorityat various hierarchylevels includingauthorityfor approvingexceptions.

*c)*Risk identification, measurement, monitoring and control

*d)*Risk acceptancecriteria

*e)*Creditorigination andcreditadministration andloan documentation procedures

*f)*Roles andresponsibilities ofunits/staff involvedin origination and management of credit.

*g)*Guidelines on management ofproblem loans.

**2.8 Credit Administration**

GuidelinesforCommercialBanksfor PakistanBanks(2010)indicatedongoing administrationofthe creditportfolioisanessentialpartofthecreditprocess.Creditadministrationfunctionisbasically a backofficeactivity thatsupportandcontrolextensionandmaintenanceofcredit.Atypicalcredit administration unitperforms followingfunctions:

a.Documentation

b.CreditDisbursement

c.Credit monitoring.

d.LoanRepayment

e.MaintenanceofCreditFiles

f.CollateralandSecurityDocuments

**2.9 Loanmonitoring**

Creditriskmonitoring referstoincessantmonitoring ofindividualcreditsinclusiveofOff-Balance sheet exposures to obligors as well as overall credit portfolio of the bank. According tothe GuidelinesforCommercialBanksforPakistanBanks,Banksneedtoenunciateasystemthatenables themtomonitorquality ofthecreditportfolioonday-to-day basisandtakeremedialmeasuresasand whenany deteriorationoccurs.Suchasystemwouldenableabanktoascertainwhetherloansare beingservicedasperfacilityterms,theadequacyofprovisions,theoverallriskprofileiswithin limitsestablishedby managementandcomplianceofregulatory limits.Establishinganefficientand effectivecreditmonitoringsystemwouldhelpseniormanagementtomonitortheoverallqualityof thetotalcreditportfolioanditstrends.Consequently themanagementcouldfinetuneorreassessits creditstrategy/policy accordinglybeforeencounteringany majorsetback.Thebankscreditpolicy shouldexplicitly provideproceduralguidelinerelatingtocreditriskmonitoring.Attheminimumit should laydown procedurerelatingto:

I. The rolesand responsibilities ofindividuals responsible for creditrisk monitoring
II. The assessment procedures and analysistechniques (forindividual loans&overallportfolio)
III. The frequencyof monitoring
IV. Theperiodicexamination of collaterals and loan covenants
V. The frequencyof site visits
VI. Theidentification of anydeterioration in anyloan

**Impact ofMicrofinanceontheRural Economy**

Theintroductionofmicrofinancehasinmanywaysimpactedontheruraleconomyandbrought aboutmany changesinagriculture,ruralhousing,womenempowermentandsavings,reductionin vulnerability ofthepoortoadversecircumstances,increasedhouseholdconsumptionandreduced incomepoverty.Thedevelopmentoftheagriculturesectorinanyeconomy hasbeenrecognizedas very importantinattemptstoreduceruralpoverty.Itrequirestheinfusionofcapitalintotherural economy toenhancetheircapacitytoacquiretheneededtechnology toenhanceproduction.In countriessuchasGhana,Uganda,andBoliviawhere agriculturedevelopmentiscentraltorural poverty reductiontherehasbeenarenewedinterestinfindingthebestwaysinproviding financial intermediationthatwouldensuresufficientsupply offundstothesector.Sincemostconventional bankinginstitutionsaretraditionally veryreluctanttoentertheagriculturesectormicrofinance institutions have emerged to fill thevoid.

Tomitigatetheseproblemsmany RuralandCommunity Bankshavebeenencouragedby successive Ghanaiangovernmentsto establish branches inthe ruralareas toprovidefinancial intermediationto thesepoorruraldwellersthataremostly intoagriculture.Theavailabilityofmicrofinancefacilities alsoenablesthesefarmers andfishermentobetter negotiatebusiness arrangementswithbuyers and processorsas theydo not now depend on thesebuyers forcreditto do theirbusiness.

Thepooraregenerally vulnerabletochangingcircumstancesandmicrofinancehelpstoreducetheir vulnerability.Microfinancehelpsborrowersreducetheirvulnerability againstadversecircumstances bybuildinguphouseholdassets.Thesecanbedisposed- offifnecessarytoraisefundsintimesof hardships.Theseassetscanalsobeusedassecurity whenthey alsoseekforcreditfrommore conventional financial institutions.

**3 Data Analysis and Discussion of Results**

*3.1 Source of data*

The primary source of data collection was employed through the use of questionnaires. The researcher usedbothquantitativeandqualitativemethodsof datacollectiontogather thedata.With thehelpofthecredit officersofthebank,theloancustomerswereinterviewedthroughthe questionnairesastheygooutfortheirnormalmonitoring.Theresearchergavethequestionnaireto theBoardofDirectorsandthestafftogivetheirresponse.The purposeofthese techniqueswasto allow discussion and probingto ascertain themicro-credits management atthe bank.

Secondary data was obtained from documentary sources such as books, journals, newspapers, reports,articlesandotherresearchrelatedtothisstudy.Thesesourceswerevery usefulinthe literaturereviewaboutmicro-creditsmanagement.The literaturereviewedservedasboththeoretical and empirical base forthe analysisof thedata collected.

*3.2 Sample*

Purposivesampling andaccidentalsampling techniqueswere usedfor thisstudy.Thepurposive sampling allowedthepicking ofinterviewobjectsthatfitthefocus ofthe study(Osuala,2001).Also, accordingtoKumekpor(1989)citedinMensah(1997),withthepurposivesampling,thesample unitsare selectednotbaseonrandomprocedure butintentionallyselectedforthestudy.Thisisbased onthefactthattheyhavecertaincharacteristicsthatsuitthestudyorbecauseofcertainqualitiesthey possess, which arenot randomlydistributed in theuniversebut necessaryforthe study. Thesample sizewas 220.

**Table4.11CorrelationmatrixofAppraisalfactorsandpolicyfactorsandimpactofthe loans**

| | Pearson Correlation | Appraisal factors | Policyfactors | Loan‘s boost of customer's activities |
|---|---|---|---|---|
| Appraisal factors | Correlation | 1 | .785** | -.322 |
| | Sig. (2-tailed) | .001 | .208 | Sig. (2-tailed) |
| | N | 17 | 14 | 17 |
| Policyfactors | Correlation | Correlation | Correlation | Correlation |
| | .785** | .785** | .785** | .785** |
| | 1 | 1 | 1 | 1 |
| Loan‘s boost of customer's activities | Correlation | Correlation | Correlation | Correlation |
| | -.322 | -.322 | -.322 | -.322 |
| | .149 | .149 | .149 | .149 |

**. Correlation issignificant atthe0.01level(2-tailed).

**Source:Fieldsurvey, 2015**

**Table 4.12 Meanand StandardDeviationofAppraisal factors and policy factors**

| **Variables** | **Mean** | **Std. Deviation** | **Df** | **R** | **P** |
|---|---|---|---|---|---|
| Appraisal factors | 48.4706 | 10.79420 | 17 | .785** | .001 |
| Policyfactors | 29.5000 | 6.25033 | | | |

**Source:Fieldsurvey, 2015 Table 4.8 Assessments oftheloan policies**

Theresultspointsoutthatthereisastatistically significantdifferencebetweenappraisalfactors andpolicy factors.ItisobservedthatappraisalfactorsscoreofM=48.4706,SD=10.79420was foundtobesignificantlydifferentfrompolicyfactorsscoreofM=29.5000,SD=6.25033,df=17, rvalue= .785/79,pvalue = p<.001.The pvalue fallswithintheacceptedrange ofp<.05.This meanstheappraisalfactorsmakeasignificantdifferencefrompolicy factors.Inotherwords,the respondentswhohadhigherscore ontheappraisalfactorsalsohadhigherscore onthepolicy factorswhilstthosewhohadlowerscoreonappraisalfactorshadlowerscoreonthepolicy factors.Thissupportstheassumptionthatthepolicy factorsofthebankareinlinewiththe appraisal factors.

**Table 4.13 Mean and Standard Deviation of Appraisal factors and Loan’s boost of**

**Customer’s activities**

| Variables | Mean | Std. Deviation | Df | R | P |
|---|---|---|---|---|---|
| Appraisal factorsof thebanks | 48.4706 | 10.79420 | 14 | -.322 | .208 |
| Loan‘s boost of customer's activities | 1.0500 | .22361 | | | |

**Source:Fieldsurvey, 2015**

Theresultspointsoutonthecontrary thatthereisnosignificantdifferencebetweenappraisal factorsandloan‘sboostof customer'sactivities.Itisobservedthatappraisalfactorsscore M=48.4706,SD=10.79420wasnotfoundto besignificantly differentfromLoan‘sboostof customer's activitiesscore M=1.0500,SD=.22361,df= 14,r value=-.322,pvalue =p<.208.The pvaluefallsoutside oftheacceptedrange ofp<.05.Thismeanstheappraisalfactorsmakes no significantdifference fromtheloan‘sboostof customer's activities.Inother words,theappraisal activitiesdidnothaveanyinfluenceonloan‘sboostofcustomer'sactivities.Thisdoesnot support the notion that thebank‘s appraisal factorsaffect theloan‘s boostofcustomer's activities.

**Table4.14MeanandStandardDeviationofpolicyfactorsandloan’sboostofcustomer'sactivities**

| Variables | Mean | Std. Deviation | Df | R | P |
|---|---|---|---|---|---|
| Policy | 29.5000 | 6.25033 | 20 | .149 | .581 |
| Loan‘s boost of customer's | 1.0500 | .22361 | | | |

**Source:Fieldsurvey, 2015**

Inthesametoken,theresultpointsthatthereisnosignificantstatistically differencebetween policy factorsandloan‘sboostofcustomer'sactivities.Itisobservedthatpolicy factorsscoreof M=29.5000, SD=1.0500 was not found to be significantly different from loan‘s boost of customer'sactivitiesscore of M=1.0500, SD=.22361,df = 20,r value = .149,pvalue = p<.581. Thepvaluefallsoutsidetheacceptedrangeofp<.05.Thismeansthatthepolicy factorsmakeno significantdifferencefromloan‘sboostof customer'sactivities.Thefindingdoesnotsupportthe assumptionthatthepolicy factorsofthe bankarenotinlinewiththeloan‘sboostofcustomer's activities.

## 4 Findings and Recommendations

The following recommendations havebeen putacross to makethe researchcomplete.

Inruralareaswhere bankshavehighindividual microcreditdefaulting rate,grouplending can improverepaymentratewhere thegroupisformedfromareaswithhighdegreeofsocial connectedness.Themostinnovativelendingmethodologiesthatcanbeusedbythebankare grouplending,socialintermediationanddynamiclending tojoint-liablegroups'these methodologieswillsolvetheproblemofinadequateappraisal,loanmonitoring andhighdefault rate.Groupmembershavebetteraccesstoinformationonreputation,creditworthinessofthe groupmembersandcanputpressureonothermemberstorepay theloansasthefailureofany member to paythe loanwillaffect thewholegroup

Theloanpolicy ofthe bankmustbecustomer oriented.Itmusttakeintoconsiderationtheneeds andthe aspirationof thecustomers tocome outwithloan productthatwillbe beneficialtothe customer to enhancerepayment

Tobeable tosolvethe numerousproblemsof thebank,managementmustbe proactiveincredit delivery.Managementmustensurethatthebankworkwithinadvancestodepositratiosetby BankofGhanatobeabletosolveliquidity problems.Thebankofficialmustmakesurethatthey getthenecessary informationabouttheloancustomerbeforeanycreditisgrantedtothe customers.Inadditiontophysicalassetascollateralthebankcanadoptgrouplendingwhere socialcollateralandtrustare sufficientforeconomicactivepoortorepay theloan. Again,itis recommended that customer receive the loan as and when needed to avoid possible loan diversion. As much as possible the bank must avoid staff and board influence to allow institutional procedures to work.

Tobeabletomeetatleast80%loanrepaymentrequirement byBankofGhana**,**every staffofthe bankmustberesponsibleforevery loan.Theresponsibilityofloanmonitoryandrecovery should beeverystaffresponsibility.Themonitoringshouldbedoneondaily basistoimproveonloan recovery.

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