THE PALESTINIAN NETWORK for small and micro finance

Fact Sheet 3 Problem Loan Management

Every Microfinance provider faces the challenge of managing problem loans. Large or small, short or long term, all loan delinquencies threaten portfolio integrity and the profitability of lending operations. Loan delinquencies can be caused by a multitude of factors. Effective portfolio managers establish strategies for spotting and handling problem loans before the first missed payment.

In the West Bank and Gaza Strip, political uncertainty creates significant economic stress for borrowers and lenders alike. The temptation exists for banks to restrict or suspend microlending operations in an adverse economic climate. Short-term credit restriction may alleviate short-term losses, but lenders should also consider potential long-term implications such as a reduction in client base and erosion of lending capital.

Microfinance practitioners advocate taking a proactive lending approach in a difficult economic environment. Banks who work with good customers to reach solutions in trying times are more likely to retain a strong client base for future business.

Problem Loans: Understanding the Big Picture

What is My Role as a Loan Officer?

- Loan officers play three critical roles:

Portfolio Manager. Each loan officer is responsible for ensuring the quality of his/her loan portfolio, for minimizing costs and maximizing income, and for reaching groups targeted by the lender's microfinance program.

Loan Monitor. Loan officers must carefully monitor, analyze and report all portfolio activity for problem loans as well as loans in good standing.

Workout Specialist. When loans do go bad, the loan officer works with the client to get repayments back on track as rapidly as possible.

What are the Costs of Problem Loans?

- A bad loan has many hidden costs:

Time wasted collecting past-due receivables

Time taken away from developing new business

Head office, regional and branch managers' time wasted in addressing delinquency issues

The Domino Effect: Other borrowers will lose motivation to pay on time

Loss of loan program reputation

Strategies for Dealing with Problem Loans

How Can I Avoid Problem Loans from the Outset?

Screen Out Unsuitable Borrowers or Bad Business Ideas
Obtain Character References
Assess Borrower's Ability to Manage Project
Document Available Collateral Sources
Match the Size of the Loan with Repayment Abilities
Ensure Sufficient Cash Flow
Use Incentives or Disincentives to Pay the Loan on Time
Communicate "Zero Tolerance for Late Payments" Philosophy to Borrowers

How Do I Effectively Monitor the Loans in My Portfolio?

Establish and adhere to a schedule of frequent monitoring and collections visits
Let the borrower know what information he is expected to have available for every visit
Use a Monitoring Schedule Form to collect relevant data
Compare reality with your projections
Ask additional probing questions
Watch for warning signs (any indication that funds have been put to improper use)
Monitor particular risks for loan by checking production, sales and receivables levels, inventory levels and construction progress
Keep your manager informed of potential problems
Communicate concerns to the borrower before warning signs turn into actual problems

What Kind of Information Should I Monitor?

Sales trends
Overall cash flow compared to projections
Any major purchase
Sums in or out of the business
Increase in receivables or inventory

What Should I Do When the Borrower Misses a Payment?

Immediately inform your manager when the first payment is missed
Ensure the borrower understands that the lending institution will never stop trying to collect the receivable
Enlist support for collection efforts from community and relatives
Inform guarantors of loan delinquency and engage them in collection efforts
Send formal legal communication to borrower documenting delinquent loan status
Schedule time for more frequent monitoring visits to delinquent accounts
Use management approved restructuring and workout techniques to get loans back on track