

**LOAN PORTFOLIO MANAGEMENT STRATEGIES OF SELECTED COMMUNITY  
CO-OPERATIVE CREDIT UNIONS IN NORTHERN REGION, GHANA**

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**Abstract**

*The study sought to assess the appropriateness of the existing loan portfolio management strategies and processes of the cooperative credit unions in Northern Region and assess compliance with the credit union loan underwriting process. Two sets of questionnaires were administered to gather primary data in addition to the secondary data used. Purposive sampling technique was used in selecting the eleven community cooperative credit unions whilst simple random sampling approach was used in selecting loan beneficiaries as respondents. The study revealed that the loan portfolio management strategies of the community credit unions were inadequate and compliance with the loan underwriting policies and guidelines by management was weak. The study recommends amongst other measures the need for training in professional loan underwriting and management procedures for the members of the Corporate Loan Portfolio Management Team of credit unions.*

*Keywords: Loan, co-operative credit union, loan portfolio management, underwriting*

**INTRODUCTION**

In the face of low level of penetration of conventional banks in the low income and rural based economies of Ghana, Credit Unions (CUs) over the years have contributed immensely in bringing to the doorstep of the rural poor, credit services, thereby, contributing to the promotion of the agenda of financial inclusion. Proponents of the CU concept maintain that it is the best option of reaching out to the poor with interventions that aim at ameliorating the poverty incidence of the poor with assistance that does not compromise the need to reward hard work (Shafiu, 2009).

The credit union is not only meant for the accumulation of money through regular savings but it is a way of developing people through the promotion of cooperation among them (Darko, 2003). Credit Unions do not operate in isolation. Changes in the local economic environment also impact on them. The impact of variables such as economic up and down turns, social upheavals, demographic factors, physical environmental changes such as climate change impact on the businesses of members and largely influences their financial commitments such as savings and loan repayments to their credit unions.

An effective loan portfolio management (LPM) system will help sustain the confidence and trust of the members of the credit unions in two ways. First, as suppliers of the loanable funds through regular savings deposit, members will be able to access the funds when loan repayments are on schedule. Second, as the demanders' of credit, they will be able to access credit from the CU when they submit their application and meet the criteria set by the by-laws of the credit union.

Income from lending constitutes on average 80-90% of the total credit unions and other financial institutions income. Credit policies and procedures are designed to guide lending and ensure prudent lending operations. Credit Unions like banks are faced with challenges. Although there is no detailed study on the quality of the loan portfolio of Ghanaian Credit Unions, available financial reports of credit unions, external audit reports and reports prepared by non-governmental organizations suggest the portfolio at risk ratio of 30% for most community owned credit unions especially, those located in the eastern corridor of the Northern Region of Ghana.

The poor quality of loan portfolios has led to high provision for loan losses in the annual external audit reports of most of the credit unions. The financial records showed that Credit Unions provisions and bad debts written off increase annually in recent times. Therefore, the study sought to assess the loan portfolio management strategies of credit unions in the Northern Region Chapter.

### **Objectives of the Study**

1. To assess the appropriateness of the loan portfolio management strategies of selected community co-operative credit unions in the Northern Region.
2. To assess compliance with credit union loan underwriting process by the selected community cooperative credit unions in the Northern Region.

## LITERATURE REVIEW

### The Credit Union Movement

According to the World Council of Credit Unions (WOCCU), credit unions are non-bank financial institutions owned and controlled by members. Credit unions, called by various names around the world, are member-owned, not-for-profit financial cooperatives that provide savings, credit and other financial services to their members. According to Organisation for Economic Co-operation and Development (2009), credit union membership is based on a common bond, a linkage shared by savers and borrowers who belong to a specific community, organization, religion or place of employment. Credit unions pool their members' savings deposits and shares to finance their own loan portfolios rather than rely on outside capital. Members benefit from higher returns on savings, lower rates on loans and fewer fees on average.

Credit unions worldwide offer members from all walks of life much more than financial services. They provide members the chance to own their own financial institution and help them create opportunities such as starting small businesses, growing farms, building family homes and educating their children. Regardless of account size in the credit union, each member may run for the volunteer board of directors and cast a vote in elections. In some countries, members encounter their first taste of democratic decision making through their credit unions (Organisation for Economic Co-operation and Development, 2009).

Turner (2000) identified the aims of a credit union as a mixture of financial and social aims. The financial aims are mainly to promote thrift by encouraging members to save regularly and to grant them loans at a reasonable rate of interest from the pool of funds mobilized from them. The social aims are to assist members with knowledge and skills to make more effective use of their financial resources with a view of contributing towards improving their livelihoods and harmony in society.

Although, a credit union is very different from a commercial bank, the two types of organizations are potentially in competition in the areas of savings and loans in spite of the fact that the credit union does not seek a profit. The credit union is equally not a charity. Members have to demonstrate their ability to save regularly before being considered for loan. Credit unions aim at providing service to their members in a manner that ensures their financial viability and perpetual existence to serve members.

### The Credit Union Movement in Ghana

The credit union system in Ghana, like their counterparts in other parts of the world, has grown tremendously since the first credit union was set up in 1955 in Jirapa in the Upper West region by Reverend Father John McNulty. The ever increasing membership of the credit unions is a reflection of the peoples trust in the credit unions system perhaps, due to the pursuance of the

balanced path of financial viability and fulfilment of social mission and the nature of governance system since governance is vested in the people themselves. CUA (2012) indicates that there are 409 credit unions in Ghana with a total membership of 133,845 members.

### **The Credit Management Process**

Aseidu-Mante (2011) outlined the credit management process as involving the establishing of formal and legitimate policies and procedures that will ensure that:

- i. The proper authorities grant credit
- ii. The credit goes to the right people
- iii. The credit is granted for productive activities or for business or economic activities which are economically and technically viable
- iv. The appropriate size of credit is granted
- v. The credit is recoverable and
- vi. There is adequate flow of management information within the organization to monitor the credit facility.

The above interdependent process shows clearly that the task of having good quality loan portfolio is a primary responsibility of the Board and management of every lending institution which needs to set up policies and procedures that will lead to good loan underwriting and management systems to prevent the creation of loans that will eventually turn bad.

The outline provided above is in consonance with the loan underwriting principles suggested by Harold et al. (1998). They stated that underwriting standards clearly define, in measurable terms, the desired credit criteria for granting acceptable loans. The appropriate evaluation before loans are booked will reduce loan losses and will be more effective than the best loan workout skills that are used after a problem loan has been advanced. Therefore, underwriting standards should include the following:

- Assessment of the loan's purpose and associated repayment program,
- Evaluation of the major loan credit factors: character, capacity, capital, condition and collateral and evaluation of loan legality;
- Determination of the economic benefits (risk-return) to the institution;
- Assurance that speculation is prohibited; and
- Assurance that loans originated are within the institution's area of expertise.

### **Loan Underwriting Procedures of Credit Unions in Ghana**

Credit unions are governed by the provisions of by-laws which set the foundation upon which all other policies are drawn. Section 55 of the by-law identifies the loans committee as the main body responsible for the approval of loans which then reports to the board of directors. The

introduction section of the modeled loan policy of the credit unions which is developed by the Credit Union Association (CUA) and modified and adopted by credit unions sets three key objectives for the credit granting process as follows:

- i. Loans are equitably and fairly distributed to needy members, bearing in mind the capacity and capability of individual members.
- ii. Liquidity requirements and appropriate reserve ratios of the society are maintained at all times.
- iii. The incidence of loan delinquency is reduced to the barest minimum.

Articles one and two set out the requirements for qualifications for a loan in the credit unions. Article one, clause (1), states that all loan applications shall first be in writing before being made on a prescribed form provided by the credit union. Clause seven requires applicants to sign a loan contract before loans are disbursed. Clause eight mandates that the loans be insured as part of the risk mitigation strategy and finally clause nine states that all applicants should be counselled before disbursement.

Article two defines the eligibility to access credit from the credit unions. It states in general that loans shall be granted to members only with clause (i) of the same article stating that a borrower shall have completed at least six months uninterrupted membership. Article seven (7) defines security or collateral for loans which include savings and shares of the borrower and the guarantor(s) who must be a member of the credit union. Landed property and standing orders in the case of salaried workers may also be used as collateral. Article four (4) states the criteria for appraising loans by the loans committee, which includes capacity to repay, character, collateral, credit worthiness and capital.

## **METHODOLOGY**

### **Research Design**

The research design was a case study .The choice of this design was necessitated by its ability to accommodate different research techniques in data collection, and analysis (Yin, 2003b; and Gerring, 2007).

### **Sampling**

One Hundred and Thirty-one (131) respondents were selected as the sample size by the researcher. The researcher used the purposive sampling procedure of select the 11 credit unions in the northern chapter of CUA. 120 members of the credit union were selected using the simple random sampling procedure to select 11 borrowers each from the loans registers or logbooks.

## ANALYSIS AND DISCUSSIONS

### Demographic Data

Respondents for the institutional questionnaire were both male and females. Male respondents were 82% and female 18%. The respondents were in the senior management category as managers and accounts officers as their job title. The managers were 64% and Accounts Officers 36%. Most of the respondents constituting 55% had served in their job position within 1-3 years. 27% had served between 4-6 years and 18% served above six years. The respondents, therefore, had the requisite working experience to respond to the questions on behalf of their respective credit unions. This is shown on Table 1 below.

Table 1: Demographic Profile of Institutional Respondents

<b>Gender of Credit Union respondent</b>	Frequency	Percent
Male	9	81.8
Female	2	18.2
Total	11	100.0
<b>Job Title of staff</b>	Frequency	Percent
Manager	7	63.6
Accounts officers	4	36.4
Loan Officer	0	.0
Total	11	100.0
<b>Year Served in position</b>	Frequency	Percent
1 - 3 years	6	54.5
4 - 6 years	3	27.3
6 and above	2	18.2
Total	11	100.0
<b>Educational Qualification of staff respondent</b>	Frequency	Percent
University Degree	2	9.1
HND Diploma	10	90.9
Total	11	100.0

### Appropriateness of Credit Union Loan Portfolio Management Strategies

#### *Loan Approving Authority*

All the credit unions surveyed indicated they had a loan portfolio management system. Similarly all of them agreed they had a loan policy that guided credit management in their credit unions. Again all of them identified Loans Committee, Board of Directors and Management as constituting the corporate loan portfolio management team in their respective credit unions. However, 73% of respondents stated that the loan committee was the main organ of the loan

portfolio management team, 18% mentioned the Board of Directors as responsible for the loans while 9% gave the role to the management comprising the manager and his staff. This analysis shows that whilst the loans committee is identified as the key part of the loan portfolio management, management and Board of directors also play a role in the management of loans in the credit unions. This is shown on Table 2 below.

Table 2: Loan Approving Authority

Officers	Frequency	Percent
Loans Committee	8	73%
Board of Directors	2	18%
Management	1	9%
Total	11	100.0

### ***Strategic Loan Portfolio Objective***

In terms of the management of the loan portfolio in accordance with a laid out strategic loan portfolio plan, 36.4% of the respondents agreed that their credit unions had a strategic loan portfolio plan but 63.6% reported not having such a plan. Among the credit unions who responded having a strategic loan portfolio plan majority stated growth in loan portfolio as their key strategic loan portfolio objective followed by profitability. The distribution was 75% for the growth in loan portfolio as the strategic objective as against 0% for quality, 0% for composition and 1% for profitability. This gives indication of the sources of challenges in the management of the loan portfolio of the credit unions. This is shown on Table 3.

Table 3: Strategic Loan Portfolio Objective

Response	Frequency	Percent
Yes	4	36.4
No	7	63.6
Total	11	100.0

### ***Loan Portfolio Risk Identification and Management***

With regards to loan portfolio risk identification and management system in the credit unions, 27% responded having such a system in place and 73% responded not having any such systems. Only loan repayment default risk was identified by respondents who stated having a risk identification and management system in place as the only loan portfolio risk faced by their credit union. This confirms that risk identification is not a key factor in the loan assessment processes of the credit unions. This is shown in Table 4 below.

Table 4: Loan Portfolio Risk Identification and Management

Response	Frequency	Percent
Yes	3	27%
No	8	73%
Total	11	100.0

### ***Effectiveness of Loan Tracking Management Information System***

The dominant type of management information system used by the credit unions in their loan portfolio management system was computer based system which was 82% as opposed to manual systems of 18%. The adequacy of the management information system to provide timely tracking information on loans in terms of quality, risks monitoring among others was assessed during the survey. 63.6% of the respondents stated their MIS did not provide such checks and information but 36.4% stated their MIS did provide such information to management. Table 5 shows data on this finding.

Table 5: Effectiveness of Loan Tracking Management Information System

Responses	Frequency	Percent
Manual	2	18%
Computer Software	9	82%
Total	11	100

### ***Performance of Loan Stress Testing***

The study found out that 91% of the credit unions did not do stress testing by measuring and analysing the impact of environmental variables to predict borrowers' ability to repay their loans. 9% of respondents said, it did such stress testing. Lack of knowledge and skills in stress testing was cited as the reason for the non-performance of stress testing. This is shown in Table 6.

Table 6: Performance of Loan Stress Testing

Responses	Frequency	Percent
Yes	1	9%
No	10	91%
Total	11	100.0



### ***Comprehensive Loan Reporting Policy***

None of the credit unions responded having a comprehensive loan portfolio reporting policy established by the board of directors which specifies the content, frequency, timing and responsible officer of the task of reporting.

### **Credit Union Loan Underwriting Process**

#### ***Loan Origination***

The loan underwriting processes involves the Credit Unions internal processes through which loan application of borrowers go through before they are approved and disbursed to the applicants. It is simply the credit decision making process. The study found out that 73% of credit union respondents did not request their loan applicants to submit writing application as a first step when originating the loan. The same number said their applicants simply completed a prescribed loan application form. All credit unions said as part of their loan underwriting process clients were interviewed before loans are granted to them. This is shown on Table 7 below.

Table 7: Loan Origination

Response	Frequency	Percent
Fill application form	8	73%
No Answer	3	27%
Total	11	100.0

#### ***The Power of Loan Committee in Approving Loans***

As regards the authority to approve loans, 100% of respondents stated that the Loans Committee was the body charged with that responsibility according to the provisions of the article 55 of the by-laws of the credit unions. However, the loans committee did not have absolute authority in the majority of the credit unions to approve all loans. 72.7% of the institutional respondents agreed to this whilst 27.3% said their loans committees were empowered to approve all loans applied for by members. The eight credit unions stated that loan request equal to or beyond threshold are referred to the Board of Directors with the recommendations of the loans committee before such loans were approved after the loans committee had given its recommendation. Also loans to the staff and other committee member were referred to the board for approval. Loans to a board member are approved by the loans committee after it has been scrutinised by the supervisory committee and discussed and recorded in the minutes at the board meeting.

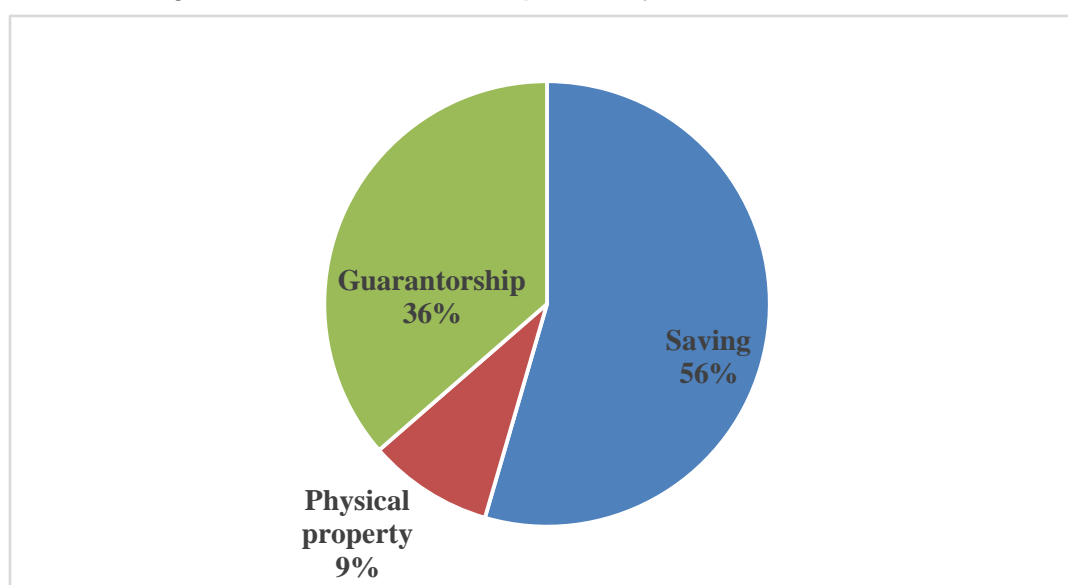
Table 8: The Power of Loan Committee in Approving Loans

Responses	Frequency	Percent
Yes	3	27.3
No	8	72.7
Total	11	100.0

### ***Loan Eligibility and Collateral***

The eligibility or qualification for accessing loans from the Credit Unions is limited only to the members of the credit unions. All credit unions stated that loans were not granted to non-members. The collateral requested from loan applicants as security for loans was savings balance of the potential borrower in the credit union followed by a guarantor who had to also be a member of the credit union. The least collateral requested was physical property such as landed property, vehicles, jewellery, or other immovable properties of the applicant. Figure 1 below illustrates the degree of collateral requested by the credit unions from their loan applicants.

Figure 1: Loan Collateral Requested by Credit unions



### ***Verifiability of Clients Financial Statements***

Analysis of the financial statements of the loan applicants was not done by 82% of the credit unions before loans were granted to them. Financial statements were not requested from the applicants by this category of credit unions to help in assessing the capacity of their businesses to utilise the amount requested and to generate enough income to repay the loan on timely basis. The main variables used by all the credit unions to assess applicants' willingness to

repay their loans were income levels, commitment level of the member to the credit union in terms of savings and previous loan repayment history and nature of business operated by the applicant.

Table 8: Variables for Assessing Applicant's Willingness to Repay Loans

Variable	Frequency	Percent
Income Level	2	18.2
Commitment Level to CU	6	54.5
Nature of Business operated	3	27.3
Total	11	100.0

### ***Loan Terms, Interest Rates, and Conditions for Borrowers***

In managing the concentration and composition of the loan portfolio of every financial institution, the portfolio must be segmented according to the product and nature of borrowers. The loans issued should be priced with different interest rates and issued on different loan terms. Contrary to this rule for effective loan portfolio management, 73% of the credit unions used the same interest rates to apply to all categories of loans. For example, different borrowers who acquired loans for different purposes such as business, personal, agriculture loans for a one year term are charged 19.5% as interest on the loans in spite of the different risk levels inherent in those loans. Table 9 shows data on the findings.

Table 9: Loan Terms, Interest Rates, and Conditions for Borrowers

Responses	Frequency	Percent
Yes	3	27%
No	8	73%
Total	11	100.0

### ***Loan Portfolio Insurance***

As part of the risk management of the loan portfolio of financial institutions, loan insurance is usually employed as a risk transfer mechanism to mitigate the impact of credit risks on the operation of financial institutions. 91% of the credit unions surveyed had taken insurance cover for their loans. Only one (1) Credit Union did not take such insurance cover for its loans. Of those who insured their loans, the insurance was focused on the life of the borrower only which covered risks emanating from death and permanent disability of the borrower. Risks such as business failures, negative impact of the weather on farmers' productivity and repayment

capacity for instance were not covered. The insurance therefore does not provide a comprehensive cover for credit risk exposures of the borrowers and the credit unions. This is shown on Table 10 below.

Table 10: Loan Portfolio Insurance

Responses	Frequency	Percent
Yes	10	90.9
No	1	9.1
Total	11	100.0

### ***Awareness of Legal Provisions on Lending in Ghana***

The Borrowers and Lenders Act of Ghana, Act 773 of 2008 was passed by the Parliament of Ghana to provide a guide for lending business in the republic of Ghana. All financial institutions are therefore required to have knowledge of this act and its provisions to guide their lending activities. In contracts, all the credit unions stated they were not aware of this Borrowers and Lenders Act. The unawareness of such a legal regulation and its provision in the loan underwriting and administration processes of the credit unions could lead to the granting of the loans in a manner that the courts will be ineffective to deal with. This could be a contributing factor to the mounting bad loans in the books of the credit unions and the seeming lack of faith in the courts by most of the credit unions.

## **CONCLUSION**

All the credit unions did not have a clear understanding of the importance of having strategic loan portfolio objectives in place to guide the management of the loan portfolio. Majority of the credit unions had risk identification and management systems. The main portfolio risk identified was default risk. Loan Insurance was the main risk management tool used. The insurance however covers only the life of the borrowers and did not cover other risks associated with their businesses.

The management information systems used by the credit unions could not provide timely information on loan quality, risk monitoring, stress indications and testing. No comprehensive portfolio reporting policy specifying content, frequency, timing and responsible official has been established by the boards in the credit unions. All categories of loans were issued on the same terms and conditions and managed with the same principles. The loan portfolio is not segmented in most of the credit unions to reflect their different levels of risks. All credit unions were not aware of the existences of the statutory legal provisions in the Borrowers and Lenders Act of Ghana (2008) and how they are applicable to their lending practices. The loan approving

authority was too much vested in the hands of the loans committee in majority of the credit unions. Additionally, there were no limits set with regards to how much the loan committee could approve. Compliance with the loan underwriting standards and procedures stated in the loan policies was a challenge in most of the credit unions.

## **Recommendations**

For a sound management of the loan portfolio of the credit unions, the following based on the findings of the study are recommended:

For a well-focused and effective loan portfolio management, credit unions must have documented strategic objectives in the area of portfolio quality, growth, profitability and concentration that would guide the loan underwriting and management process.

The management information systems of the credit unions should be upgraded to a system that monitor and provide sufficient, accurate and timely information to management on the condition, quality and performance of the loan portfolio that will be useful in guiding prudent decision making and effective loan tracking and monitoring.

The Board of Directors of the Credit Unions should establish a management reporting requirement. This should be well defined to ensure that the board receives adequate information to monitor portfolio performance with regards to the objectives and goals set by the board and to respond to changing conditions and risks in the lending environment.

The loan policies of the credit unions should be reviewed regularly to make it in line with current credit management standards. The powers of the loans committee in approving loans in the credit union enshrined in the by-laws should be reviewed to include other members of the Corporate Loan Portfolio Management Team to make them active participants in the credit granting decision making process.

Training Programmes on effective credit underwriting and approval procedures need to be organized for the Corporate Loan Management Team. Both qualitative and quantitative loan appraisal procedures and tools should be stressed during the training. The loans committee and management should be trained to identify asymmetric information provided by prospective loan applicants in order to minimize the incidence of adverse selection which increases the probability of repayment default of the obligor. In addition, the team should be trained to gain an appreciation of the legal provisions of the borrowers and lenders act of Ghana 2008, (Act 773) to assist them in their credit decision making and recovery of loans.

## **Limitations of the Study & Scope of Future Research**

The study was limited to the Northern region as a result of resource constraints to conduct a nationwide research. This undoubtedly affected the sample size used and the generalization

arising from the study may not reflect the actual circumstances in specific locations. Some of the respondents might have provided dishonest responses which might affect the scientific underpinnings for the study. These notwithstanding, rigorous processes were used to obtain as valid data as possible which were carefully analyzed to reach acceptable findings and conclusions.

The coverage of this study was limited to the Northern Region of Ghana. Future studies should involve a wider scope to provide a more scientific output. The theoretical scope should also be broadened to cover areas of loan delinquency and recovery.

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