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Improving on non-performing loans in the microfinance sector of Rwanda

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I) Executive Summary

The Rwandan microfinance sector suffers from a high ratio of non-performing loans (NPL). The target of Rwanda National Bank is a maximum of 5% non-performing loans – the current ratio is largely above 10% (up to 46%)¹.

The objective of this thesis is to identify reasons for the high NPL ratio and provide recommendations for improvement.

These recommendations are primarily based on the findings of 32 questionnaire-based interviews of approximately 45-90 minutes conducted with SACCO (Savings and Credit Cooperatives) and MFI (Microfinance Institution) managers, credit clerks and some direct clients across Rwanda. The theoretical research is based on the 2016 financial statistics of almost 400 Umurenge (municipality) SACCOs provided by the National Bank of Rwanda (BNR).

The four main structural shortfalls, separated in findings (F) and Recommendations (R):

(1) Education

(F) Insufficient financial education of employees and customers

(R) Define minimum education standards for staff and committee members and follow the dual system training approach. Conduct standardized customer trainings.

(2) Standardization

(F) The official standardized loan process is not followed

(R) Implement a core banking system across all SACCOs/MFIs, a fraud proven collateral evaluation process and ease the exploitation of collaterals. Establish continuous internal and external audits.

(3) Products

(F) The product structure is inflexible, nontransparent and not customer oriented. The interest rates are extremely high.

(R) The maturity should match the debtors' earnings and be enlarged. The interest rate should consider solvency and customer scoring.

(4) Sustainable, goal-driven incentives

(F) The incentives are based on rapid, quantitative growth

(R) Establish a balanced scorecard for incentives regarding different KPIs such as quality and quantity of business.

Rwanda is an ambitious country with strong partners and supporters. Having seen the overwhelming effort that has been put into the financial system so far, we see a lag of

¹ With some branches experiencing also lower ratios of 0.5%, focus of this work lies on the major part of loans with a non-performant share of >15%

implementation. As a strong overall recommendation, we would like to stress that it is crucial to accompany and control the implementation of the recommendations as well as the expected outcome and continue with the same level of effort to improve the financial system as in the past years.

II) Introduction

Rwanda – one of the 54 Sub-Saharan African countries – is a country with ambitious targets for its development. In 2012 it revised the program “Vision 2020”. Herein, 48 objectives are defined to raise the people of Rwanda out of poverty and transform the country into a middle-income economy (Republic of Rwanda, 2012).

Rwanda recognized that to improve its economic situation, it will need to advance the financial system, improve financial education and introduce easy access to loans with microfinance. The Government of Rwanda installed a general framework with the “Umurenge SACCOs Strategy” (Umurenge SACCOs Strategy, 2009).

The financial system of Rwanda is divided into three sectors: Commercial Banks, MFIs (Microfinance Institutions) and SACCOs (Savings and Credit Cooperatives).

Microfinance takes place in MFIs and SACCOs. Microfinance grants easy access to funding for small commercial or agricultural businesses to individuals or smaller groups. The National Bank of Rwanda allows SACCOs/MFIs to issue loans only if overall non-performing loans (NPL) do not exceed 5% of overall assets. In 2016 the average ratio of non-performing loans was at 12.5% in SACCOs and 7.5% in MFIs (Annual Financial Stability Report, 2017). Institutions reaching a level above 10% of non-recoverable loans are not authorized to grant new loans (Microfinance Regulations, 2009).

Microfinance is not just lending money. SACCOs/MFIs offer various products like saving accounts or insurances. Apart from this, two different approaches exist in microfinance: the minimalist one which is just focused on financial intermediation, and the integrated one, which also contains social intermediation, enterprise development services and social services (Microfinance Handbook, 1999). In Rwanda we almost always experienced the integrated approach – even though there is lot of room for improvement.

Non-performing loans (NPL) are an accompanying topic within the microfinance sector. According to recent World Bank statistics, the world-wide NPL ratio lies at 3.9% of total gross loans in 2016. The NPL ratio for the Euro Area is at 4.1%, with the highest impact in Italy with 17.3%. In the Sub-Saharan Africa region, the 2016 NPL ratio was at 9.6%; in Uganda at 10.4%; Tanzania at 9.6% and Rwanda at 7.1%. (Bank, 2016). In September 2017, the National Bank of Rwanda published ratios of 8.2% of NPL as of June 2017. Microfinance institutes increased to 12.3% in June 2017 vs. 11.7% in March 2017. (National Bank of Rwanda, 2017). The trend of increasing NPL ratios within the microfinance sector has been seen since 2014, however the real root causes have not been identified. Consequently, structured activities for mitigation have not been set and implemented.

The Savings Banks Foundation for International Cooperation (SBFIC) issued the research assignment on how to improve non-performing loans in the microfinance sector of Rwanda – the topic of this Master Thesis.

III) Background: Rwanda as a country

Macro economics

In 1962 Rwanda declared independence from Belgium introducing first regional elections in 1999 and held first country-wide elections in 2003. Rwanda is ranked the 76th densely populated country in the world, with 11.9 million inhabitants. For comparison, Rwanda has a higher population than Greece with 10.5 million inhabitants. The population is over-proportionally young with a share of 40% of people below 30 years. 21% of citizens have no formal school education, 54% have various schooling qualifications.

Rwanda is a small country with 26,338 square kilometers. For comparison, Switzerland, also considered a small country, has 41,277 square kilometers. Natural resources are limited and are predominantly comprised of gold, tin, tungsten and methane, as well as agricultural areas. 74.5% of the land is used for agriculture, 18% of the land is forested.

With a GDP of 22.8bn USD, Rwanda is ranked 141 globally, neighboring Burundi with a GDP of 7.8bn USD at 163. The GDP growth rate was 5.9% in 2016. Rwanda was able to continue the positive development of recent years and is now ranked 28 on GDP growth world-wide. For every 100 inhabitants in 2016, 69 had a mobile phone (rank 98 worldwide) and 20% had access to the Internet (rank 120 worldwide). (The World Factbook, 2017).

Economy

75.3% of the working population works in agriculture. Only 10% of the agricultural products are exported and contribute to the export volume. With 745m USD in 2016 Rwanda ranks 165 globally for export. Mostly coffee, tea, hides and tin were exported to their main partners: Congo, Kenya, United Arab Emirates, Switzerland and Burundi. The export volume increased to 908.9 million USD in 2017 according to first projections. On the other hand, a massive trade deficit with imports totaling 2,045 billion USD in 2016 (and 2,007 billion USD in 2017), focusing on food, machinery, construction materials and petroleum products. China is accountable for 21.2% of that, with 11.2% coming from Uganda and other partner countries worldwide (2016). (The World Factbook, 2017).

Rwanda as a member of the EAC (East African Community) and the COMESA (Common Market for Eastern and Southern Africa) has been the top consistent economic reformer

since 2008 and second-easiest place to do business in Sub-Saharan Africa (Doing Business Report, 2017). In Rwanda, new businesses can be established within 6 hours after registration with the Rwanda Development Board (RDB, 2017).

The agriculture sector contributes to one third of the total GDP of Rwanda. It is the main economic activity for rural households (especially women) and remains their main source of income. It is estimated that the agricultural population accounts for slightly less than 80% of the total population. The sector covers 90% of national food needs and generates more than 50% of the country's export revenue.

Within the short and medium term, Rwanda intends to continue to focus its efforts on traditional crops of tea, coffee and pyrethrum. Rwanda is developing on nascent non-traditional horticultural crops, including various fruits and vegetables, flowers (mainly fresh roses); essential oils (pyrethrum, patchouli, etc.), stevia, dairy products, meat, poultry and fish.

The agriculture sector is expected to accelerate growth from 5.8% in 2016 to 8.5% by the end of 2018, and exports will be maintained at an average growth rate of 17%, from 19.2% to 28% per annum. (RDB, 2017)

Vision 2020

The high trade deficit was one of the key drivers of the Vision 2020 initiative launched by President Kagame. Vision 2020 consists of various measures in Rwanda's key sectors and is the basis for the economic development of Rwanda.

„The Vision 2020 identifies six interwoven pillars, including good governance and an efficient state, skilled human capital, vibrant private sector, world class physical infrastructure, modern agriculture and livestock, all geared towards prospering in national, regional and global markets. (Rwanda Vision 2020, 2012).

Building on Vision 2020, the Financial Sector Strategy was defined by MINECOFIN and AR (Access Finance Rwanda) with external support on behalf of the Ministry of Finance and Economic Planning in 2013.

The main objective of the Financial Sector Strategy is described as follows: “to achieve a more sustainable economic growth and development, we need a deepened, broadened and

developed financial system, well-regulated and competitive, an inclusive and financially literate population to accelerate growth“.

The Financial Sector Strategy is gaining in relevance through its objective to establish access to a stable financial system and to reduce the lack of skilled labor especially in rural areas. (Rwanda Financial Sector Strategy, 2013).

Banking Rwanda

The financial sector of Rwanda is regulated by the Ministry of Finance and Economic Planning, and the National Bank of Rwanda (BNR). The central bank is accompanied by Banque Rwandaise de Développement (FRG) to safeguard and stabilize the banking system.

The growth of the financial sector continued in 2016 as well as in previous years. According to the government, its stability, structure and efficiency have improved significantly due to more stringent enforcement of the regulations by the central bank.

The authorities are actively taking steps to improve access to finance and promote the creation of new financial institutions. Already in May 2007 the government decided on the program to develop the financial sector (FSDP) to establish a comprehensive framework and detailed activity plan for its development. The numbers of Savings and Credit Cooperatives (SACCOs) is increasing. The goal of spreading SACCOs is to increase the local access to financial services above the current 20% ratio of population. Microfinance institutions (MFIs) are expanding, although many are still unable to self-finance, develop new products or broaden their reach for rural customers. (Making Finance Work for Africa, 2017)

Previous shortcomings of land ownership and registration that hindered the development of mortgage products were tackled, paving the way for a functioning housing finance framework through a centralized registry.

4,342 employees in the traditional banking and branch business are employed by 12 commercial banks, 3 microfinance banks, a development bank and a cooperative bank. 183 branches ensure only a small percentage of the population have geographically easy access to the finance institutes. Rwanda's important microfinance sector brings together 15 local companies, 416 Umurenge SACCOs and 63 non-Umurenge SACCOs, which provide easy access to financial services in rural areas (RDB, 2017).

Umurenge SACCOs

This section will detail the background of the Umurenge and non-Umurenge SACCOs.

90% of the population of Rwanda today live within 5 kilometers of a SACCO. Establishing Savings and Credit Cooperatives is a success story of the financial inclusion in Rwanda established only in 2008 by the President of Rwanda. Within a very short time, from 2011 to 2014, the SACCOs managed to win 1.6 million customers. SACCOs and other micro finance institutes (MFIs) served almost the same number of residents as the entire urban banking sector in 2014.

In 2008 a survey revealed that only 21% of the Rwanda population had access to formal financial services and 52% were completely excluded financially before the government of Rwanda intervened.

The strategy developed in 2009 included the goal of creating at least one SACCO in each Umurenge of the country, providing people with access to financial services, especially savings, loans and transactions, at a low cost.

SACCOs are member cooperatives. Since most people in Rwanda were familiar with cooperatives and their regulations it was easier to mobilize people to start their own cooperative by applying the same principles. In retrospect, the National Bank of Rwanda believes that it would have been more difficult to set up limited liability organizations driven by profit rather than SACCOs working to maximize benefits for its members.

Furthermore, the SACCOs are managed by the members themselves, which should ensure ownership and social responsibility for a positive business management. The minimum capital requirement for SACCOs is relatively low, making equity capital or buying into the cooperative more affordable for Rwanda's low-income population. (FinScope, 2016).

Products within the banking sector

Savings

In Rwanda, the reserve of capital is less in line with the goal of classic capital accumulation. Only a small share of the adult population (14% in 2016, from 29% in 2012) uses no channel to save money. The different institutional and informal channels for investing or saving capital are often used in parallel. 35% say they save money at home in a secure place, 48% use informal opportunities such as local savings groups, 45% trust other formal (non-banked) organizations and only 13% of the adult population manage their capital in classic banking institutions. (FinScope, 2016).

Loans

72% of Rwanda's adult population borrows money from various sources to cover their daily needs or to grow agricultural products. The banking sector plays a virtually negligible role with only 4% of loan sourcing. 13% use other formal (non-banked) organizations. The strongest provider of capital with 61% of loans are informal sources. In addition to the saving groups, traditional money lenders and shop owners themselves are used. 32% of the loans come from family and friends. Taking into consideration the overlap of individual sources of capital, informal sources continue to be the most common source of capital at 51%. (FinScope, 2016)

Banking customers

Rwanda, a young democracy, is developing economic structures, however struggles with the comparatively low economic education of its population.

Based on the 2015 FinScope Rwanda Survey with international and local initiators, it becomes clear that access to economic education – even on a simple scale – is often not available. Only the capital Kigali stands out with a share of 20% compared to the rural regions with 10% of adult economic education.

Through surveys and interviews of 12,480 inhabitants, a picture of a growing economy and increasing social interest in financial market products has been identified. 48% of adults have at least a deposit-based account which represents an increase of 18% compared to 2013/2014. 86% save money – the most widespread forms are with Umurenge SACCOs (27%) and mobile money savings with 17%. (FinScope, 2016).

Rwanda is vastly rural and depends heavily on agriculture. Agricultural loans vary between 2% and 85% share of micro credits granted in SACCOs or Micro Finance Institutes (MFI).

IV) Key areas of analysis

We have identified four elements that have a significant impact on the share of non-performing loans within any banking system, including the Rwandan microfinance sector. These four elements structure our work in terms of analysis and recommendations.

a) Customers

This section describes the structure of customers within the microfinance sector in Rwanda.

During our interviews we could confirm our hypothesis established from the research in terms of customer education, financial knowledge and credit customer share. However, the customer base and share per customer segments vary heavily within the branches, even within the same districts and Umurenge areas. Also, the total number of customers, borrowers and the number of dormant accounts vary from 400 active customers to 6,000. Borrowers range from 15 to approximately 500 loan customers.

According to the interviews, general customer credit segments are split in agricultural (42%), commercial (31%), transport (8%) and others (19%). During the interviews the SACCO/MFI branch customer profile was not immediately known by the branch managers. Almost all had to refer to the monthly statement, or in many cases guessed a share of customer profiles.

84% of the Rwandan population are based in rural areas, about 20% of the population do not have a formal education; approximately 50% hold a primary education and sources of income vary greatly on a monthly and annual basis (FinScope, 2016). 54% of adults have more than one source of income – this relates greatly to the agricultural sector where 51% report an income from farming and only 9% report income as a wage from a farmer.

As stated above in the introduction section, the agricultural sector plays a significant role in the Rwandan economic profile. During the interviews we could confirm an average agricultural loan amount in a range between 200.000 and 400.000 RWF (230 to 460 USD). The majority of the agricultural loans were used to expand own product ranges, add live-stock or extend the farming area. In almost all agricultural sectors, individuals were the customer rather than groups with main focus on maintaining their living and supporting their own family.

We could only relate larger scale operations to group financing aspects. Group financing in the agricultural sector nearly irrelevant. Only five SACCOs out of 32 had a portfolio share of group lending between 30% up to 50%.

Group NPL ratios are reported by the branch managers to show a lower NPL to individual loans. The overall social pressures due to common collaterals as well as the community spirit are main drivers for a higher willingness to repay.

The overall credit amount to groups is approx. 10 times higher compared to individual credits. Although damage to the SACCOs is higher when a group lending fails, group lending is more reliable referring repayment.

In three SACCOs/MFI branches the branch manager focused heavily on financial education and core banking principles before disbursing the loans. In all three branches the NPL ratio is below 5% on an annual basis. Two MFI managers conduct additional specific loan trainings to group borrowers. Both institutes reported overall NPL ratios of 3%.

Commercial loans are mostly used to set up small local enterprises and trading businesses. SME (Small and Medium/Micro-sized Enterprises) represent 95% of all trade businesses. 93% employing between one and three people, businesses with one employee account for 72% of all businesses. Growing the SME sector has been a strategy since 2006 to lower the trade deficit of Rwanda. Many initiatives have been established by the Government of Rwanda (GoR) to develop business and technical skills. Trade ranges from selling coffee, tea and other agricultural products to local trade for furniture, small manufacturing and other services in rural areas of Rwanda.

Due to the short loan time frame, of up to a maximum of three years, the loans are not geared towards larger business models. Details of the product portfolio are given below in the product section of this document. The Rwanda Development Board (RDB) has recently established a new program to support young professionals to start their own business after finishing a B-Level education (vocational school). The Rwanda Development Board was established as an independent organization to consolidate investor experience of all government departments under one roof, supporting business investments backing the Vision 2020 of Rwanda. For each district a Rwanda Development Center with focus on the private sector has been established. The centers support and educate locals in establishing business operations.

Small transport businesses represent a share of 8% of loan customers to the SACCOs and MFIs. Loans are used to purchase a motorcycle, car, truck or minibus to provide transport

and logistics services to the community. The transport community is mostly run by individuals setting up a service enterprise containing a single employee. (Ministry of Trade and Industry, 2017).

We could not identify programs stimulating diversity or innovation whilst conducting the interviews. Mostly the same customer base was served in neighboring locations selling the same products. In previous years, the Business Development Authority (BDA) supported programs driving business start-ups managed by women. This changed in 2016 and it now focuses on young adults just graduating from secondary schools. The focus on young professionals has sparked a negative trend in NPL ratios in approximately 20% of the SACCOs/MFIs interviewed.

Financial Education of customers

During all interviews, the participants confirmed that despite the efforts outlined by the Vision 2020 program of the Rwandan government, the overall financial education of all customers remains low. Enormous efforts have been placed into educating the youth in secondary school. The program aimed at improving knowledge on:

1. Day-to-day cash flow management
2. Financial planning for the future
3. Financial services including tools such as savings, loans, insurance, grants, etc.

The financial education program by segment is geared towards the below listed objectives:

FE Program by Segment

| Segment | Objectives |
|--|--|
| Children 0 to 13 years | Build a strong foundation for responsible money management by developing good planning and saving habits |
| Youth 14 to 35 years | Prepare youth financially for life cycle events, such as entering the work force, and take charge of managing their own finances |
| Urban Adults 36 to 65 years | Provide urban adults with higher incomes and more education additional knowledge and skills to best take advantage of advanced financial products and partake in higher levels of financial planning |
| Rural Adults 36 to 65 years | Provide basic education on budgeting, savings, debt management and financial services information in order to increase financial capability |

Source: National Financial Education Strategy for Rwanda, August 2013

Due to resource constraints adults aged 36 and older (urban and rural) have been mostly excluded from the educational program.

Financial burden

In addition to the low financial understanding, the financial burden placed on borrowers is high in comparison to western mature economies.

The overall interest rates range between 18 – 24% depending on SACCO/MFI and product chosen (if any product variations are available). Personal income tax ranges from 0 to 30%. No income tax needs to be paid for an annual income below 360,000 RWF (~430 USD). From 360,001 RWF to 1,200,000 RWF a tax rate of 20% is applied. Above 1,200,001 RWS (~1,425 USD) an income tax rate of 30% is charged (RRA, 2017).

The government supports the economy through VAT exemption on agricultural products, in addition to the many local economy support services such as transport, medical and other goods. (RRA, 2017). Despite the ease of VAT reduction, the overall financial burden for many borrowers remains high.

During the interviews we tried to get more details and information on the reason why borrowers are not paying their installments on time or not at all. The topic of misuse of credit was often raised – however could not be quantified by the managers as there is no track data of why loans are not performing within their SACCO/MFI.

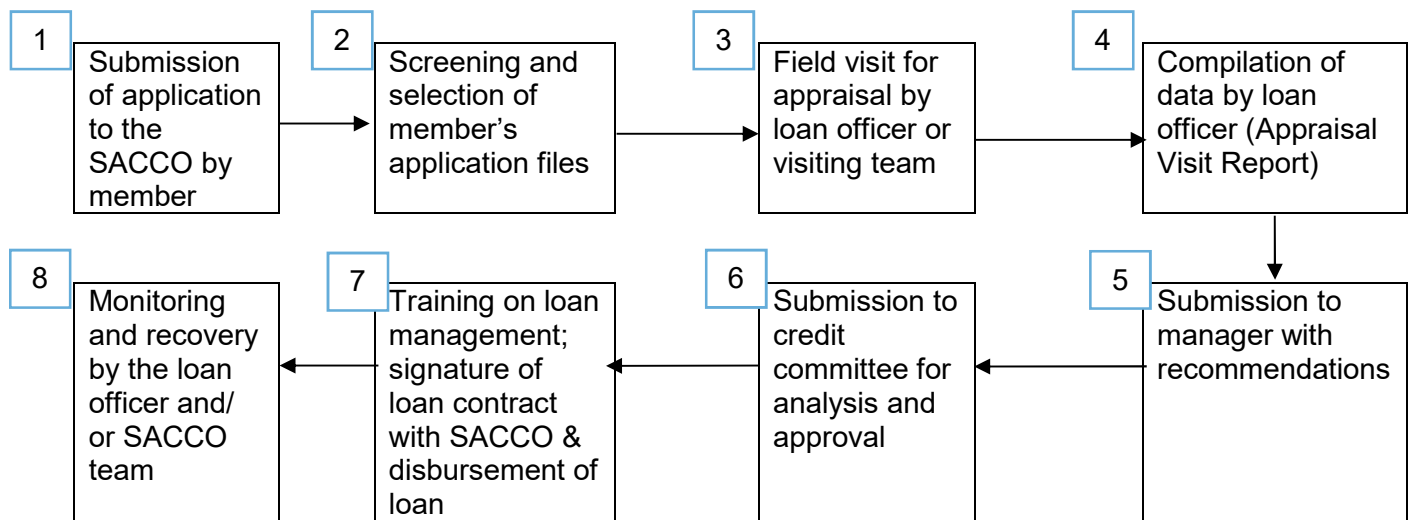
Recommendations

- 1) Further focus on group loans to support larger farming units with a greater efficiency and output. Identify true entrepreneurs during the group lending period and support their development further
- 2) Establish a structured customer profile program and adapt communication and training/educational aspects based on the profile on budgeting, saving, and cash flow planning
- 3) Emphasize further on financial education and increase capabilities and capacities, in particular for rural areas

b) Loan process

In the following two sections we will detail the steps of the loan process including dunning. During the interviews we identified that the process steps were similar throughout the different SACCOs with small deviations.

LENDING PROCESS FOR SACCO MEMBER (General Assembly Umurenge SACCOs, 2014)



A core banking system is currently being implemented in some Umurenge SACCOs. To support process adherence and controlling, a country-wide implementation is highly recommended.

1. Submission of application to the SACCO by member

1.1. Involved parties: customer and loan officer

Customer:

A detailed focus on customers is given under the topic customer in chapter 1.

Loan officer:

According to the UMURENGE SACCO Credit Policy, 2014:

The main functions and responsibilities of the loan officer are:

- take applications and complete the required documentation for loans;
- maintain professional communication and follow-up with member through the various stages of the lending process;

- assist members in person, answering questions regarding lending policies and general credit union policies; and
- assemble data required to process, close, and service loans as requested by qualified members. (General Assembly Umurenge SACCOs, 2014)

In our interviews we did not evaluate customer relationship management (CRM) or detailed documentation of knowledge gained in a customer file. There is no digital CRM tool available and documentations are collected in a paper-based file.

We focused on the hiring requirements and educational background of the loan officer. In most of the interviews the educational background was secondary school (High School) with a diploma in accounting/management or other financial sector related topics. Very few SACCOs requested a Bachelor degree. The minimum age for a loan officer was largely 21.

Before executing the job, the employees walk through training(s). During our interviews we could not identify a uniform procedure of structured training.

The hiring process is not uniform and the requirements are not equal. In some SACCOs staff members are selected by the credit committee with a strong influence of the branch manager. In other branches the loan officer is related to the branch manager or to one of the influential members of the credit committee. We were told that bribery occurs.

Recommendations

- 4) Train and educate the loan officer with a structured and comprehensive training program with several well-defined modules, combining theory and practical experience (dual apprenticeship system). The methodology should be very participatory and include group work etc. for a higher probability of usability in practice
- 5) In addition to theoretical knowledge, establish a structured on-the-job training to improve the quality assurance and validation of the documents presented by the customer
- 6) Establish a common and transparent hiring process across all SACCOs/MFIs

1.2. Application of loan

The application process, the first touch point of customer and SACCO staff, is generally an interview. The interviews are not customer-oriented. The loan officer guides the customer through a conversation that strongly resembles an interrogation. The objective is to collect

all required documents but not to determine the relevant product/solution for the specific customer's requirements.

Recommendations

- 7) Re-focus on the service approach for the customer. Customer-focused advice and a mindset of service delivery will help to expand customer satisfaction
- 8) Establish a basic training for customers raising awareness of their duties and how to handle a credit and the repayments

1.3. Supply of documents

The required documents vary greatly between the interviewed SACCOs/MFIs. Some documents were mandatory by all, others were occasionally requested. The list below represents the mandatory and occasionally required documents:

Mandatory for all:

- Active member of SACCO for 1-3 months
- Application document
- Copy of ID
- Collateral papers in original
- Registration of collateral
- Credit reference bureau
- RDB Rwanda Development board

Mandatory for some:

- Project plan
- Copy of marriage certificate
- BDF guarantee sheet (in case collateral not sufficient)
- CRB registration
- Guarantee (individual)
- Business Plan (BDA)
- Overview of income and expenses
- Cash flow calculation
- Form for authority registration
- Work force development authority

According to the Credit Policy of Umurenge SACCOs the below documents are the mandatory requirements to apply for a loan: (General Assembly Umurenge SACCOs, 2014)

- Project description which shows profitability
- Collateral original ownership documents (Fixed assets)
- Guarantor's agreement
- A balance, income sheets and cash flow for the business for the last 2 years and projection for the next following year (business plan)
- Copy of ID card of guarantor
- Insurance policy for collateral

In addition to the documents listed above, the borrower (individual) must bring the following documents:

- Photocopy of national ID card of borrower
- For borrowed collateral, the owner(s) and spouse must write a letter confirming use of asset as a loan collateral
- Civil status (Sector certificate attesting the status)
- For married people, both spouses must sign on a collateral agreement, if one of them is abroad, s/he should send proxy signed before a notary
- A balance sheet, income statement and cash flow for the business and family for the last 2 years and projection for the next following year (business plan)
- Photocopy of ID Spouse
- Salary slip
- Employment contract

Recommendations

- 9) Set up and agree on a common minimum requirement of documents with a defined quality of information. For example, a detailed project plan as part of the minimum required documents
- 10) Revise the current version of the credit policy for SACCOs/MFis to harmonize the policy regarding the processes
- 11) Make sure that capacity and knowledge to follow the credit policy is amassed – this could be part of the dual system as mentioned above
- 12) Set up an external and internal audit system to make sure that the defined processes are followed

2. Screening and selection of members application files

The loan officer checks the provided documents for quality and quantity. If the documents do not fit the needs and requirements of the SACCO the loan officer rejects the further process.

Recommendations

- 13) Loan officer to give recommendations to the customers what must be improved before rejecting the application
- 14) Establish customer interaction, advisory and service standards
- 15) Establish customer service and customer handling training program for loan officers

The above recommendations will lead to increased customer service. In In some SACCOs clients were accompanied by third parties to complete their loan application. This might be proof for the need to strengthen the overall customer service and advisory aspect.

2.1. Charging fees

In any case (approval of documents or rejection) the customer is charged a fee for verification. This fee differs between 1% of the requested credit amount and in some cases fixed 1,000 RWF (1.19 USD). Later in the process a second fee is charged.

Recommendations

- 16) Introduce the obligation to make fees and prices transparent. The compliance should be ensured through a central auditing
- 17) Communicate with high transparency to the customers at what time which fees are to be expected
- 18) Establish a common standard fee to process the loan

3. Field visit for appraisal

The collateral visit process often starts with the collection of an additional fee of 3,000 RWF (3.56 USD). This fee is justified with travel expenses.

Most MFIs accept fixed assets (land or housing) only as collateral but do not have a uniform process to evaluate the value of collaterals.

The value of a collateral is always stated as 100% of the market value. This differs to the German approach of collateral value where the evaluated value is reduced by 15%-25% to calculate the realization value. This reduction should cover the costs and expected losses of exploitation.

The Umurenge SACCOs Credit Policy (2014) gives a concrete statement:

“In the evaluation process, the loan officer should be able to distinguish between the market value and realization value. Market value is always greater than realization value. The SACCO only considers the realization value.”

The evaluation can be done either by the loan officer or the branch manager. In few cases, mostly for loan values greater than 500.000RWF, the SACCO or MFI uses an external appraiser to value the offered collateral. These appraisers are educated with special evaluation trainings. Loan officers or branch managers are not always trained on evaluating collateral.

The Rwandan approach is to collect securities in the value of 150-200% of the total loan amount.

This represents a huge hurdle to apply for a loan. Many customers are not able to offer adequate securities. These customers try to motivate family and friends to work as their guarantor which generates new problems: total number of guarantors, evaluating each guarantor's credibility and the documentation of the total guarantee sum is difficult to distinguish between “good” (in the meaning of credibility) guarantor and bad guarantor.

Recommendations

- 19) Follow the Umurenge SACCOs Credit Policy of 2014
- 20) Fundamentals of the decision should be:
 - a. Solvency of a customer proven by cash-based accounting
 - b. Evaluation of the detailed business plan
 - c. Available collaterals (not as a main focus)
- 21) Re-evaluate collateral security levels

As a result of these recommendations, it will become easier for customers to get a loan in the SACCO. This will increase the credit reach for customers who cannot offer collaterals in the requested amount. Focus will be on repayment and the funded business ideas will become more sustainable. These two outcomes will contribute to a sustainable improvement of the NPL ratio.

We do not recommend dropping all collaterals but to reduce the hurdle, e.g., consider e.g. 100% collaterals of the applied loan sufficient.

3.1. Credit report

The final step in this subchapter is the credit report that is compiled by the loan officer. This credit report represents the main decision document and is the basis for all further steps and decisions. The document contains the findings of the prior steps and includes a recommendation by the loan officer.

The evaluation should be structured around the 5c-scheme. (Umurenge SACCO Credit Policy, 2004)

- Character
- Capital accumulation
- Capacity to repay and cash flow
- Collateral
- Conditions

Only 3 out of 34 interview partners reflected this scheme for orientation. A universal acceptance could not be proven in our interviews.

The loan officer has no authority and is not allowed to approve or deny a loan. This leads to a crucial problem: The loan officer writes a report with the intention of bringing about a

decision. However, the following levels of competence interpret the report as a recommendation to award the loan.

Every level of competence is relying on the level below. The denial rates of the branch managers are between zero and 30%. The denial rate of the credit committee is in all cases below ten percent. We could not prove a correlation between the denial rate of the credit committee and the NPL ratio. However, we see a correlation between the intensity of how the credit committee is involved in the process and their ability to make decisions, and the quality of the provided loans – the more the credit committee decides (approve or deny) the better the loan portfolio should be.

Recommendations

- 22) Strictly comply to the 5c-scheme
- 23) If the written report of the loan officer is viewed as the willingness to offer the loan, the loan officer should be equipped with the authority to vote

4. Submission to manager with recommendations

4.1. Involved parties (new): Branch manager

Hiring requirements for branch managers were mostly a finance-related bachelor degree with at least two years of work experience. In a few cases, the branch manager had to run through several trainings which, however, do not include leadership-related education.

During the interviews with the branch managers we experienced missing controlling skills. Most branch managers were unable to reflect on their performance with KPI's, in particular regarding their monthly Key Facts Statement (KFS) to the Rwandan Central Bank (BNR). Even though the information in the reporting is very detailed, only few managers showed a professional handling and in-depth knowledge about their results. We are questioning the depth and accuracy of the elaborations if the users do not understand the evaluation and their performance.

Recommendations

- 24) Educate and train the branch managers with a uniform and comprehensive training program. Controlling, leadership, methodical training and coaching of employees must be emphasized during the training
- 25) Conduct regular audits of the SACCOs and branches to secure a reliable, understandable and sustainable controlling system based on the well-elaborated

BNR sheet. It is key that the branch managers comprehend their KPIs and steer the business based on the knowledge gained

4.2. Evaluation of case by branch manager

One key task of the branch manager is the evaluation of the loan officer's credit report. For this evaluation we could not find a unified procedure. Most of the branch managers performed a formal quantity check of documents. Quality check is largely referring to the written statement of the loan officer. In a few cases the branch manager visited the collaterals to verify the value. The branch manager's statements reflected that this happened mainly to check the loan officer's work, rather than to evaluate the correct value of the collateral. Branch managers told us that fraud attempts sometimes occurred during the evaluation process. Loan officers were bribed to set higher values and grant higher loans.

The authority to approve loans for branch managers was between 0 to 500,000 RWF (594.08 USD). After the branch manager evaluates the report, the branch manager comments (sometimes) and signs (always) the report to give it to the next level of authority.

Recommendations

- 26) Establish centralized authority for evaluation and fixing of land values
- 27) Agreement of all financial institutions to follow those land values
- 28) Establish fraud-resistant control system for collaterals. Using the authority to prove value for property, based on regional facts and fixed land values as mentioned above.

To implement this, a centralized authority for evaluation and fixing of land values is required.

4.3. Optional - Staff board approval discussion

In very few cases, the branch manager called a staff board of the branch for further credit approval. The staff board consisted of the branch manager, the loan officer and the accountant. The documents and the appraisal were discussed and, if accepted, signed for further procedure.

Recommendations

- 29) Establish a staff board committee where the discussion mode is not authority-driven. Every participant must have the same right to speak and use this right for critical arguments. If this is not possible this committee softens the decision process with more people involved and should not be established.

5. Submission to credit committee for analysis and approval

5.1. Involved parties (new): credit committee member and credit committee president

The credit committee consists of three to five members from the adjacent area of the SACCO. This could be the cell but in almost all cases, it was the Umurenge. During committee sessions one representative of the MFI/SACCO is present.

The educational background of the credit committee president was generally a Bachelor's degree with a financial or business-related background. The other members of the credit committee had no requirements regarding educational levels.

The credit committee is elected by the general assembly for a 2-3-year period with a maximum of two tenures per member.

The credit committee discusses the loan and makes the final decision. The denial rates of the credit committees are very low (on average below 10%). The competencies are vast - from rejection or changes on collaterals to the total loan amount or interest rate.

Recommendations

- 30) Establish standardized educational programs for all members of the credit committee accompanied by web-based trainings or frequent trainings in banking related topics
- 31) Connect approval authority to the loan officer as he is closest to the borrowers
- 32) Increase competencies of the loan officer, following the organizational congruence principle: Task – Competence – Responsibility (Reiß, 1982)

6. Training on loan management; signature of loan contract with SACCO

The branch manager or loan officer informs the customer of the success or failure of his loan application. The customer is invited for a further appointment where the contracts are signed and possible changes to the elements of the contract are explained.

The contracts are signed by branch manager, loan officer, customer and guarantors.

In most cases, an additional fee of 1% of the final approved loan amount is charged. Some branch manager regarded those fees not to be for the SACCO/MFI but for individual use

for the branch manager. Some paid team events such as lunch or dinner, others used it to compensate for additional transportation costs. In few cases this money was for personal use of the branch manager/loan officer.

According to the Umurenge SACCOs Credit Policy (2014) the branch manager must inform the borrower of the details of the credit granted including the following topics:

- Explain the importance of the credit
- Explain the calculation of interest rate
- Give each member - borrower a copy of the repayment schedule
- Answer any questions raised by the borrower.

This is called the branch manager training of the borrower. (General Assembly Umurenge SACCOs, 2014)

Recommendations

- 33) Conduct borrower trainings at the beginning of the process
- 34) Implement mandatory questionnaire for customers before disbursement to prove sufficient knowledge of the customer

The basic reason to establish SACCOs was to guarantee access to the capital market. Fees should not keep customers away.

6.1. Disbursement of loan

The involved staff are the loan officer, accountant and teller. The accountant is responsible for the manual continuation of the credit and deposit book. The other involved roles were not in focus on this assignment and we did not evaluate hiring requirements of an accountant or teller.

The disbursement is mostly done immediately to the deposit account of the borrower. Only very few MFIs/SACCOs transferred the money directly to the creditor or disbursed in installments. This practice avoids misuse.

Recommendations

- 35) Broaden the disbursement of the loan to the creditor of the loan customer
- 36) Disburse in installments according to the (proven) need of the customer

c) Dunning process

This chapter contains a brief summary of the dunning process, our findings and recommendations as well as the methodology.

In the interviews we focused explicitly on the dunning process. No interviewee needed a work instruction or a procedure plan. We trust that the procedure is well known and common in handling.

Every manager developed his/her own dunning process with a wide differentiation of success as seen in the NPL ratio.

In the table shown in the appendix, the official Umurenge process is compared to the explained process in the interviews.

We see that the SACCOs intensified the number of contacts to their clients. No SACCO has fewer contact than the official procedure prescribes.

High deviations are seen when legal forces are included, and official letters should be sent. As branch managers know about the unlikelihood of a legal enforcement and the high costs involved, the stronger instruments of the dunning process are not used frequently. This causes problems in the follow-up in case of exploitation.

We could identify in the interviews that an intense and close relationship to the customer decreased delayed payments.

Recommendations

- 37) Establish a valid and nationwide dunning process based on the most successful SACCOs regarding NPL and credit portfolio
- 38) Ensure monthly meetings with selected borrowers to increase the willingness to repay

Structured monthly meetings held to recognize problems at an early stage will also have an impact on financial education. Overall this might be an opportunity to gradually increase smaller credits and enlarge credit know-how.

d) Products

Product portfolio diversification

The allowed amount of granted loans depends on the total assets of a SACCO. The minimum net worth must be 15% corresponding to the total assets (Microfinance Regulations, 2009). The total quantity of loans given to a single person, legal entity or group is limited to 5% of the total net worth of the institution.

Credit portfolios contain loans for commercial business (mostly shop owners), transportation, agricultural or house construction. Few SACCOs show a concentration of 70% - 90% agriculture in their portfolios. No clear correlation between the diversification of the portfolio and the location of the SACCOs (city/rural area) can be seen.

We could not correlate NPL ratios to diversification of loan portfolio. Diversification is not the influencing factor for the level of NPL ratio.

Credit products and customers' needs

Loan products available in the SACCOs/MFIs are mostly common. The product spectrum is standardized among the different purposes of the credit: agriculture, commercial, transportation or construction.

The maturity of the loans ranges from 4 to 24 months. Loans with a repayment cycle up to 36 months are rare. Some institutions match the annuity and the maturity to specific product/business needs, e.g. the cycle of the harvest.

Many SACCOs in the more rural areas do not offer product varieties and are only involved in products with fix maturities and annuities.

Most loans are annuity, a few products have fixed interests extending beyond maturity. In general, it is cheaper for the customer to take an annuity loan. But the shown interest rate of annuity is higher than the fixed.

Most customers compare the absolute height of the interest rates. They conclude that fix is cheaper, while in reality it is more expensive. This reflects once more the poor financial knowledge of the customers.

The height of the interest rate takes into account that of the competitors and is decided democratically by voting of the members of a SACCO.

It differs within a range of 24% - 35%. The interest rate does not depend on the quality or value of collaterals or on the scoring of the customer. It depends on the asked amount and on the existence of a positive track record of borrowing by the customer. The majority of rural SACCOs offer only one loan product with set interest rates.

Small loans frequently show a higher interest rate than larger ones. No strong regulations exist regarding how to determine interest rates. Subject to Microfinance Law the interest rate must recover the operating expenses (Microfinance Law, 2008).

If a loan is secured by the Business Developments Funds (BDF) the interest rate decreases to 15%-18%. The BDF can cover between 50% and 75% of collaterals required by the lending institution. It can be used for fixed assets and working capital loans (BDF, 2017).

The loan amounts range in general between 100,000 RWF and 1m RWF (120 USD to 1,190 USD). Main purposes for usage are: agricultural development, investments in mobility, opening of a commercial shop/restaurant, personal loans. Credits higher than 5m RWF (5,950 USD) are hardly granted and require additional approval processes.

Cross-selling as a business case

The distributed products in a SACCO/MFI are not limited to credits. They offer payment and savings accounts and, as intermediary activities, insurances. If a customer applies for a credit, there are mandatory and voluntary products he has to take out.

In all SACCOs/MFIs it is necessary to open a payment account. Especially in SACCOs customer must deposit a certain amount to gain shares and become a member of the SACCO.

In almost all interviews conducted, a life insurance policy was a mandatory requirement in order to disburse the loan. In most cases products of the insurance company SORAS were recommended and sold. Commission levels to the SACCOs/MFIs were stated between 10-15%. Other voluntary products sold in combination with loans are payment protection, paralization, fire or climate-change coverage.

Many customers are rejected when applying for payment protection insurance or a climate change insurance because the risk for the insurance company that the insurance case occurs is too high. But it can be stated that the intermediation of insurances is a profit-yielding business for the SACCOs: it is risk free, often mandatory to get a credit, very easy to sell and the earned commissions are high.

Recommendations

- 39) Amend loan conditions to customer requirements and needs – the design of the contract has to match the purpose of the credit
- 40) Extension of maturity lowers the installments and leads to amortization of debts
- 41) Decrease interest rate by including the BDF as guarantor if possible
- 42) Link the level of interest rate to the solvency and collaterals of the client
- 43) Implement a scoring system to value the individual credit exposures

e) Incentives

One part of the questionnaire was also the aspect of incentives for the individual employees at each MFI/SACCO. Which incentives are available to employees; what KPI's are measured; and how much impact does the incentive have on the overall earning capabilities of the employees? We mainly focused on incentives for loan managers as they are the key drivers and have the greatest influence on the success rate of loans.

Key findings

There is not one common approach within a specific district or organization. Nine interviewed branches (30%) reported an incentive program in place. Only four have an attractive and high performance-oriented program. Five branches have a common incentive for achieving the overall goals of the SACCO/branch. MFI institutes generally have a more structured and performance-oriented incentive in place.

In four of the interviewed branches (12%) the achievable incentive of the loan officer is almost equivalent to the level of an annual base salary. In two branches the loan officer incentive can outperform the incentive of the branch managers. Both cases belonged to MFIs.

Where SACCOs/branches use an incentive system, we saw strong variances within the regions/Umurenge, as well as mostly unstructured incentive systems with unclear KPI measurements such as NPL ratio or contribution to SACCO/branch performance, overall loan amounts and new customer revenue.

The incentive models used for the loan officers included all or some of the following components:

- Total amount of disbursed loans
- Mobilization of customers with new loans
- Branch specific NPL Ratio < 3% or < 5%
- Interest income for the branch/SACCO
- Overall financial performance SACCO to annual target
- Individual behavior rewards (subjective incentive)

Recommendations

- 44) Establish a common incentive model for loan officers and align the loan officer target as a share to the branch manager incentive
- 45) Set comprehensive key performance indicators
- 46) Develop incentive model further with a 360 degree balanced scorecard approach

Measures should be based on:

- Value of non-performing loans and default loans in percentage to loan amounts
- Linked to the income /loan amount of the SACCO's/MFI branch
- Overall target of the branch/SACCO
- Value of new customer acquisition
- Value of repeat customer acquisition
- Customer training and education scores

The incentive model should be designed with the following aspects and goals in mind:

- Motivate staff to overachieve objectives and targets
- Change behavior and attitudes
- Easy to calculate and understand
- Measurable on a monthly basis
- Incremental value of the incentive could target 80% value of the fixed annual income
- Consideration of setting the incentive without a capped threshold to support the overall results of the SACCO/branch and the surrounding areas

V) Conclusion

The overall set-up and design of the micro-finance environment within the Rwanda banking system, together with the envisioned processes, support a successful operation. What has been achieved in a very short time frame is more than impressive. We identified shortcomings of the current process nested in the implementation and execution.

The four main areas identified for improvements are education, standardization, product design and sustainability.

Education is probably the biggest hurdle to be crossed. We see a lack of financial education on both, the customer and supplier side, and this at all levels. Our recommendations aim to increase the understanding using the dual system approach giving the individuals not only the theoretical but also practical hands on experience.

Standardization, although well documented lacks implementation. A core banking system must be implemented country-wide to prevent exploitation and fraud. Implementation of a good credit process with supporting audit will support a better performing credit portfolio with high adherence to processes.

Products currently available to the public are not customer orientated and there is a lack of transparency, in particular the costs. Higher flexibility in product design combined with a higher customer orientation should lead to lower non-performing loans. In addition the overall focus on group lending should be increased as NPL ratios are significantly lower to individual lending.

Sustainability relies on a transparent and motivating incentive program. An incentive system based on a balanced-scorecard allows combining quantitative and qualitative aspects leading to sustainable and performing growth through motivated employees with greater compliance, contributing to improved results.

Implementation, continuous training, adjustments to process and procedures, plus the accompanying monitoring of standards are a challenge to achieve. If the level of involvement and efforts continue with the same drive and passion as in the past, the implementation of our recommendations are certainly feasible.

As a group we are extremely thankful to have been given this opportunity to be involved in a project that is looking to uplift a country and its people, learn about a foreign culture and improve our studies.

We are hopeful that the people of Rwanda and those looking to give them the chance to grow will be supported by our findings and be successful and allow Rwanda to prosper.

We are ready to support ongoing implementation efforts or advisory service and would welcome to contribute further to this worthy project.

A very special thank you to Britta and Thomas Konitzer (from the Savings Banks Foundation for International Cooperation) for the opportunity and support they have given us in this project.

VI) Summary of recommendations

The table below summarizes the recommendations of this master thesis. Recommendations are clustered in four main topics: Education, Standardization, Product and Sustainability.

We do recognize that implementation is the most difficult part with the granularity of the system and the many stakeholders involved, thus this structure is aimed a successful implementation as likely as possible:

| | Recommendations | Implementation Recommendations / Execution |
|------------------|---|--|
| Education | | |
| 2) | Establish a structured customer profile program and adapt communication and training/educational aspects based on the profile on budgeting, saving, and cash flow planning | Support authorities in program set-up in cooperation with AMIR |
| 3) | Emphasize further on financial education and increase capabilities and capacities, in particular for rural areas | SACCO/MFI training capacities |
| 4) | Train and educate the loan officer with a structured and comprehensive training program with several well-defined modules, combining theory and practical experience (dual apprenticeship system). The methodology should be very participatory and include group work etc. for a higher probability of usability in practice | Structured program across all institutions, alignment with all involved authorities and stakeholders, start with dedicated pilots, possible amend program after pilot and roll-out as mandatory program. |
| 5) | In addition to theoretical knowledge, establish a structured on-the-job training to improve the quality assurance and validation of the documents presented by the customer | |
| 8) | Establish a basic training for customers raising awareness of their duties and how to handle a credit and the repayments | |
| 11) | Make sure that capacity and knowledge to follow the credit policy is amassed – this could be part of the dual system as mentioned above | |
| 15) | Establish customer service and customer handling training program for loan officers | |
| 24) | Educate and train the branch managers with a uniform and comprehensive training program. Controlling, leadership, methodical training and coaching of employees must be emphasized during the training | |
| 30) | Establish standardized educational programs for all members of the credit committee accompanied by web based trainings or frequent trainings in banking related topics | |
| 33) | Conduct borrower trainings at the beginning of the process | Set questionnaire and develop loan customer |

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|------------------------|---|---|
| 34) | Implement mandatory questionnaire for customers before dismemberment to prove sufficient knowledge of the customers. | training program linked to results of questionnaires |
| Standardization | | |
| | Implement a core banking system across all SACCOs/MFIs with standardized instructions. | Continue with current training and roll-out of banking system. Mandatory in order to achieve common approach and standardization level. Basis and fundament for further development |
| 9) | Set up and agree on a common minimum requirement of documents with a defined quality of information. For example, a detailed project plan as part of the minimum required documents | Revision of credit policy and set binding standards. Increase resources at beginning for audit purposes. |
| 10) | Revise the current version of the credit policy for SACCOs/MFIs to harmonize the policy regarding the processes. | |
| 12) | Set up an external and internal audit system to make sure that the defined processes are followed | |
| 14) | Establish customer interaction, advisory and service standards | |
| 18) | Establish a common standard fee to process the loan | |
| 19) | Follow the Umurenge SACCOs Credit Policy of 2014 | |
| 25) | Conduct regular audits of the SACCOs and branches to secure a reliable, understandable and sustainable controlling system based on the well-elaborated BNR sheet. It is key that the branch managers comprehend their KPIs and steer the business based on the knowledge gained | |
| 26) | Establish centralized authority for evaluation and fixing of land values | |
| 27) | Agreement of all financial institutions to follow those land values | |
| 28) | Establish fraud-resistant control system for collaterals. Using the authority to prove value for property, based on regional facts and fixed land values as mentioned above. | |
| 37) | Establish a valid and nationwide dunning process leaned on the most successful SACCOs regarding NPL and credit portfolio. | |
| 43) | Implement a scoring system to value the individual credit exposures | AMIR / SBFIC |
| Product | | |
| 39) | Amend loan conditions to customer requirements and needs – the design of the contract has to match the purpose of the credit | |

| | | |
|-----------------------|--|--|
| 40) | Extension of maturity lowers the installments and leads to amortization of debts | |
| Sustainability | | |
| 6) | Establish a common and transparent hiring process across all SACCOs/MFIs | |
| 44) | Establish a common incentive model for loan officers and align the loan officer target as a share to the branch manager incentive | Develop first approach of common incentive program. AMIR / SBFIC Test with selected pilots, review results and possible amend program. Agree on uniform roll-out and develop further after first results. |
| 45) | Set comprehensive key performance indicators | |
| 46) | Develop incentive model further with a 360 degree balanced scorecard approach. | |
| Other | | |
| 1) | Further focus on group loans to support larger farming units with a greater efficiency and output. Identify true entrepreneurs during the group lending period and support their development further | Training program for branch managers and district managers. Develop group lending program with customer acquisition model and tailored products. |
| 7) | Re-focus on the service approach for the customer. Customer-focused advice and a mindset of service delivery will help to expand customer satisfaction | |
| 13) | Loan officer to give recommendations to the customers what must be improved before rejecting the application | |
| 16) | Introduce the obligation to make fees and prices transparent. The compliance should be ensured through a central auditing | |
| 17) | Communicate with high transparency to the customers at what time which fees are to be expected. | |
| 20) | Fundamentals of the collateral decision should be: a. Solvency of a customer proven by cash-based accounting b. Evaluation of the detailed business plan c. Available collaterals (not as a main focus) | |
| 21) | Re-evaluate collateral security levels | |
| 22) | Strictly comply to the 5c-scheme | |
| 23) | If the written report of the loan officer is viewed as the willingness to offer the loan, the loan officer should be equipped with the authority to vote | |
| 29) | Establish a staff board committee where the discussion mode is not authority-driven. Every participant must have the same right to speak and use this right for critical arguments. If this is not possible this committee softens the decision process with more people involved and should not be established. | |

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| 32) | Increase competencies of the loan officer, following the organizational congruence principle: Task – Competence – Responsibility (Reiß, 1982) | |
| | | |
| 35) | Broaden the disbursement of the loan to the creditor of the loan customer | |
| 36) | Disburse in installments according to the (proven) need of the customer | |
| 38) | Ensure monthly meetings with selected borrowers to increase the willingness to repay | |
| 41) | Decrease interest rate by including the BDF as guarantor if possible | |
| 42) | Link the level of interest rate to the solvency and collaterals of the client. | |

VII) List of abbreviations

| Abbreviation | Expansion |
|--------------|--|
| AMIR | Association of Microfinances Institutions in Rwanda |
| BDA | Business Development Authority |
| BDF | Business Development Funds |
| BM | Branch Manager |
| BNR | National Bank of Rwanda |
| BoD | Board of Directors |
| BRD | Banque Rwandaise de Développement |
| CC | Credit Committee |
| COMESA | Common Market of Eastern and Southern Africa |
| CRM | Customer Relationship Management |
| EAC | East African Community |
| FSDP | Financial Sector Development Program |
| GoR | Government of Rwanda |
| KFS | Key Facts Statement |
| KPI | Key Performance Indicator |
| LO | Loan Officer |
| MFI | Microfinance Institutions |
| NPL | Non-Performing Loans |
| RRA | Rwanda Revenue Authority |
| RDB | Rwanda Development Board |
| RWF | Rwanda Franc |
| SACCO | Savings and Credit Cooperatives |
| SBFIC | Savings Banks Foundation for International Cooperation |
| SME | Small and Medium/Micro-sized Establishments |
| USD | US-Dollar |

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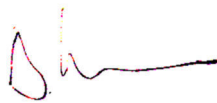
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IX) Appendix

a) Declaration of Originality (joint or group thesis)

We hereby confirm that this Thesis presented has been prepared independently and according to the agreed project plan, using no other sources, resources and other aids than those mentioned. All parts – literally or by their meaning – taken from published or non-published sources are credited as such. The Thesis in its current or similar form has never been submitted as a graded assignment. Changes to the topic or the project plan have been agreed with the first assessor.


Frankfurt, 19.02.2018



Benjamin Hermanns



Ingrid Johnson



Selina Weißer



Fabian Winkler

b) Dunning Process in detail

Comparison between the official Umurenge SACCO version and the findings of our interviews

| Official Umurenge SACCO version | | | Interview results | | | Evaluation |
|---------------------------------|-------|--|-------------------|--------------------------|---|--|
| Step: | Who | What | Who | When | What | |
| 1 | LO/BM | One (1) day before due repayment the loan officer or the manager will call the borrower to remind him/her of the payment due the next day. | LO/BM | 1-5 days before due date | Call / SMS reminder | Procedure approved |
| | | | LO/BM | 1 day after due date | Call to remind and evaluate reasons | Additional step in the SACCOs |
| 2 | LO/BM | Five (5) days after a situation of arrears is noticed, the loan officer must take action to correct the situation. The loan officer / manager will contact the borrower on the phone notifying him/her of the delay, and leave written evidence of the collection step taken. | LO/BM | Day 4-5 | Visit 1 st letter | A visit could have a stronger impact than a call. Procedure approved. |
| 3 | LO | Two (2) days after step 2 [7 days after arrear] , the loan officer must cease all activity and pay a visit to the debtor to determine the reason for the arrears. S/He must advise the debtor to immediately appear at the SACCO to pay what s/he owes. The loan officer is not entitled to accept the payment directly , but s/he may accompany the debtor or his/her representative to the SACCO to make the payment. | LO/BM | Day 5-x | Various calls, visits to motivate for repayment | The official statement describes a stricter handling of the process to what was perceived in the field. Improvement will be helpful. |

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| | | <p>The loan officer informs the debtor of the consequences of being delinquent, i.e.: a penalty (stipulating the amount), poor reputation for the next loan if delinquency persists, realizable collateral in the event of non-payment and loss of reputation in neighborhood.</p> <p>It is important for the loan officer to get the borrower's commitments (why, when and how). If the borrower fails to honor his/her commitments, then the loan officer will be justified in pursuing the collection actions by increasing the intensity of the steps. The loan officer completes his/her remarks on <u>Collections Form # 2</u>.</p> | | | | <p>We see a cultural issue in the fact of threatened loss of reputation – and this might lead to a better success-rate of the dunning.</p> |
| 4 | | <p>Fifteen (15) days after a situation of arrears is noticed, the first collection note (<u>Collections Form # 3</u>) is sent to the debtor. The note is a reminder to make timely payment.</p> | | | | <p>Uncertainty about the first collection note. Improvement required.</p> |
| 5 | BM + CC + BoD | <p>After one month, the manager asks for the assistance and help of credit committee, who will ask the guarantors to come forward. A letter "SUMMONS TO THE SACCO FOR DELINQUENT LOAN PAYMENT" will be sent to the guarantors inviting them to the SACCO for discussion. A copy of the letter is sent to the borrower.</p> <p>This Collection Form # 4 must be sent 30 days after the situation of arrears was noticed, or 15 days after the <u>Collection Form # 3</u> was sent. Within the note, a maximum deadline for the payment of the</p> | | | | <p>A concrete and valid process step is officially arranged but not followed in the SACCOs. The lack of this process step might also be due</p> |

| | | | | | | |
|--|--|---|--|--|--|---|
| | | <p>delinquent installments of 15 calendar days is granted.</p> <p>The SACCO's copy will be kept in the member's loan file and will serve as evidence that the SACCO warned the member. The chairperson of the BoD and the manager must sign this letter.</p> <p>The seal of the SACCO must be put on this letter and a copy will be sent to the co-signers. The manager must obtain the acknowledgement of the guarantor and the member that shows that they both receive the aforementioned letter.</p> <p>To acknowledge the reception of "SUMMONS TO THE SACCO FOR DELINQUENT LOAN PAYMENT" letter, the guarantor and borrower sign on that copy and the latter will be retained at the SACCO.</p> <p>The manager and the chairperson of BoD will conduct a visit to the borrower place of work or residence. The manager must obtain the acknowledgement of the member on the copy that will be retained at the SACCO in the loan file. If there is one or more guarantor, remind him/ her/ them that s/he is committed to pay since the borrower has failed to repay.</p> <p>It is very important for the manager to get the borrower's commitment to come to the SACCO and pay the overdue installment.</p> | | | | <p>to the interview situation.</p> <p>We strongly recommend enforcing this step to ensure a valid and impactful process. We did not evaluate legal consequences of delayed information to guarantors.</p> |
|--|--|---|--|--|--|---|

| | | | | | | |
|---|-------------------------------|--|------------------------------|-----------|---|---|
| 6 | Local auth- orities/ BM | <p>After 75 days, if all actions have proven fruitless, the local authorities must be called in. The SACCO will use the services of the local authorities as witness. Leaders of the SACCO must accompany the manager to make the local authorities aware of the mission and role of the SACCO in the presence of the borrowers and the guarantors.</p> <p>The guarantors are officially notified to pay off the balance without delay; otherwise, legal proceedings will be undertaken. A guarantor who fails to honor her/his obligation will disqualify her/himself from any future loan application.</p> | Local auth- orities BM | Day 10-x | Visit of customer | The actually running process as performed by the SACCOs, seems ahead of the officially planned process or a sum up of the steps 4 and 5 |
| | | | LO/BM | Day 40-60 | 2 nd letter sent | If the letter has legal consequences or is needed for legal use we recommend standardizing the exact time when the 2 nd letter must be sent. |
| | | | LO/BM | Day 60-x | Various calls and visits further letters | The social pressure is raised – we cannot identify solutions for the |

| | | | | | | |
|---|--|---|----|--------|--|---|
| | | | | | | customer. We recommend focusing on solution finding, compromises, deferment of payment, extension of credit for instance |
| 7 | | <p>Taking legal action on a loan must be initiated at the latest 90 days after it became delinquent. The initiation of legal action must be communicated by the financial institution by means of a written notice to the borrower and guarantors.</p> <p>By legal means, the assets of the delinquent borrower and/or that of his surety or sureties are pursued - going as far as holding an auction so that with the proceeds from the sale of the property making up these assets, all of the debts owed to the SACCO will be satisfied.</p> <p>These controls are exercised by the SACCO through visits or direct verifications in the courts where the respective proceedings are taking place. Periodic reports that will be demanded by Management from the external attorneys on the individual status of each case. Updates of the calculation of the ordinary and delinquent loan interest should be made regularly.</p> | BM | Day 90 | 3 rd letter & legal actions | <p>Procedure approved.</p> <p>Nearly no legal actions are enforced to delinquents due to the costs of courts (50,000 RWF), lawyers (500,000 RWF) and overall travel time and costs.</p> |

c) Questionnaire for Survey

Background information: The survey is part of a master thesis of the Frankfurt School of Finance and Management, Frankfurt / Germany. The aim of the Masterthesis is to analyze the credit default rates and their causes with a focus on the agricultural sector. Part of the thesis is a survey of key stakeholders in Rwanda based on the following questions. We are grateful for the support of the SBFIC and the local experts.

| | | | |
|---------------------|---|--------------|----------------------------------|
| Documentation | <input type="checkbox"/> foto <input type="checkbox"/> video <input type="checkbox"/> audio | Email: | |
| MFI/Sacco | | Date | |
| Lastname | | Interviewer | <input type="checkbox"/> Weißer |
| Prenome | | | <input type="checkbox"/> Winkler |
| Position | | | <input type="checkbox"/> Johnson |
| Balance Sheet | | NPL (act/LY) | |
| Loan/Deposit amount | | Staff | |
| Customers | | Branches | |

1. Customer

1.1. Who are your credit customers?

*(e.g. farmer, shop-owners, corporates, age, what area do you cover
mentality of repayment of loan, willingness of repayment, is it "ok" to use loans?)*

1.2. How important are groups?

1.3. How would you evaluate the financial education of your customers?

2. Products

2.1. Which credit products does your institute offer?

Do they fit customer needs?

(product variety, target customers, 3 most sold products ...)

2.2. What is the share of the different product types/portfolio?

(Volume/percentages)

2.3. Which products can you offer in terms of cross selling?

3. Procedures

- 3.1. Could you please describe in detail how the credit-process in your MFI works?
(customer requests loan where? to whom? who does the approval process work? Differences in agricultural loans? Follow up?)
- 3.2. Which documents do you need for a loan approval and what are the requirements?
- 3.3. How are the different competences of approval organized?
(approval right of advisor, manager, committee, how is fraud avoided)
- 3.4. What is your rejection/denial quote in the different committees?
(loan committee, management committee)
- 3.5. How can you/your employees validate the value of the offered collaterals?
(Which collaterals are most common? Who sufficient is the process of validation? How reliable is the monthly income? Handling of uncertainties, Car at purchasing price, What % of security do you require? Which value do you fix?)
- 3.6. How can you exploit the collaterals?
(Dunning, access, value, time until cash out, Exploitation-rate, specialties in agricultural loans?)

4. Staff

- 4.1. What are the requirements for (becoming) a loan-officer/advisor
(Education, (Re-)Trainings/Certificates, Years on Job...)
- 4.2. What are the requirements for approval boards.
- 4.3. How are you / your employees incentivized?
(quality/quantity/base/KPIs, motivation drivers, dependencies, fixed/variable – percentages)

5. Controlling

5.1. What are the reasons for the defaults?

(What measures have you taken?)

- Misuse
- indebtedness
 - Private lending?
- Business failure/competition/bus model?
- Interest rate

5.2. How do you control your MFI loan office? Which KPIs

(IT systems/core banking systems, paper, excel?)

6. Wrap-up

1.1. If you could change anything in the loan business – what would you do?

(change, procedures, approval)

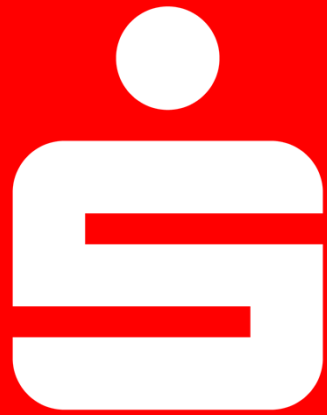
1.2. How relevant is the topic to you (1-10)

(need for improvement)

1.3. How did you like the interview? (1-10)

d) Presentation of the Thesis

On the following pages you see the presentation as held on January 30th, 2018 at the Frankfurt School of Finance and Management.



Improving on non-performing loans in the micro-finance sector of Rwanda

Benjamin Hermanns

Ingrid Johnson

Selina Weißer

Fabian Winkler





Rwanda Facts and Figures



- 13 million people (2 million in metropolitan areas)
- Size 26,300 km²
- 80% work in agriculture → of which 90% for own use
- 69% own a mobile phone (rank 98 world-wide)
- 20% have access to internet (rank 120 world-wide).

Rwanda Facts and Figures



- Independence from Belgium since **1962**.
- Democratic elections in **2003** (Democracy index world-wide 138/167)
- Transparency international – corruption perception Index 2016: 50/176
- Paul Kagame, President and Head of State since 2000

Development programs



Paul Kagame, President and Head of State



Sparkassenstiftung für
internationale Kooperation

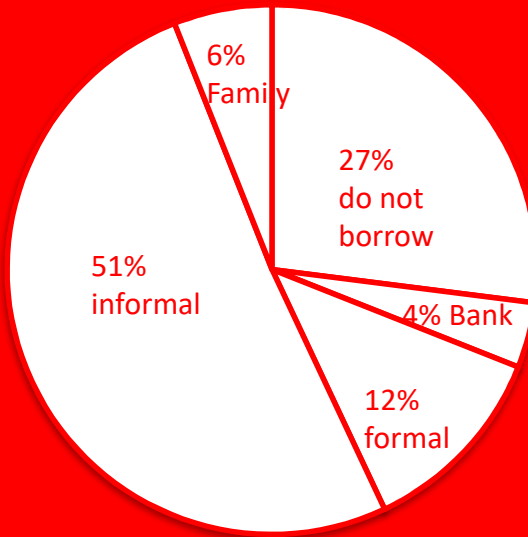
- Facts:
 - GDP: \$22,79 billion (163 worldwide)
 - Poverty Rate: 39,1% 2013/2014 (-5,8% in 3 years)
 - Exporte 2016: \$745 milion (165 worldwide)

Agenda 2020 - Its main objective is transforming the country into a knowledge-based middle-income country,

- Agenda 2020 key objectives:
 - Skilled human capital
 - A vibrant private sector
 - A world-class physical infrastructure
 - Modern agriculture and livestock
 - **Stable, sound and efficient financial sector**

Financial System

Source of credits



- Financial Sector Development Program implemented 2007
- National Bank of Rwanda established as central institute
- Fragmented financial system, historically grown "Formal Other", Informal and modern banking institutes
 - 15 centralized banks
(12 commercial banks, 3 microfinance banks, 1 development bank, 1 cooperative bank with in total 547 contact points (focused on metropolitan areas))
 - Over 479 „Formal Other“ (non- & Urumenge-Saccos)
 - Numerous local savings and credit groups
- 89% of the adults are part of the financial system.
 - 86% are saving money
 - 72% are borrowing money
 - 34% are using Mobile Money (DE number 0,3m 2016 . 1m in 2017)

Assignment and Objective



Non-performing loan ratio as a key issue within the micro-finance sector.



Target non-performing loan threshold below 5% → often between 8-20%



Identify root causes and propose solutions to reduce NPL ratios

Project Method/Focus

Improving on non-performing loans in the micro-finance sector of Rwanda

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Research and analysis: of documents



Not sufficient to identify recommendations



Explore real situation on-site

Developed questionnaire and conduct interviews



Gap analysis



Derive recommendations

Hypothesis and Interviews



Postulate hypothesis regarding: customers, products, process & procedures, staff, controlling



Questionnaire: quantitative + qualitative questions

32 Interviews

- Areas: Kigali + 9 districts
- Branches per SACCO/MFI: 1 - 45
- Employees per SACCO/MFI: 5 -186
- Customers per SACCO/MFI: 3.200 – 200.000
- NPL Ratio per SACCO/MFI: 0.5% - 46%

Productfeatures

Overview of the current
productfeatures established
in most SACCOs/MFIs



Customer

Individual and Group Lending

Purpose

Agriculture, Transport, Commercial, Mortgage,
Private loans, family issues

Volume

100,000 to 1 million RWF (120 to 1,190 USD)

Maturity

5 to 24 Months

Interest rate

18% - 35%

Repayment

Annuity and Fixed-Rate Loans

Collaterals

150 - 200% of Loan Amount





- 1 Submission of application to Sacco / MFI by member



- 2 Screening of application files



- 3 Field visit for appraisal



- 8 Disbursement and recovery

Description of the process
developed by the General
Assembly of Umurenge SACCOs.
(2014)

UMURENGE SACCO Credit Policy. Rwanda.



- 4 Creation of „Appraisal visit report“



- 5 Submission to manager with recommendations



- 6 Submission to Credit Committee for approval



- 7 Training for loan customers

System/structural shortfalls

1

EDUCATION

Insufficient financial education of employees and customers

2

STANDARDIZATION

Loan process is not followed

3

PRODUCT

Inflexible product structure

4

SUSTAINABILITY

Missing goal driven incentive

Insufficient financial education of employees and customers



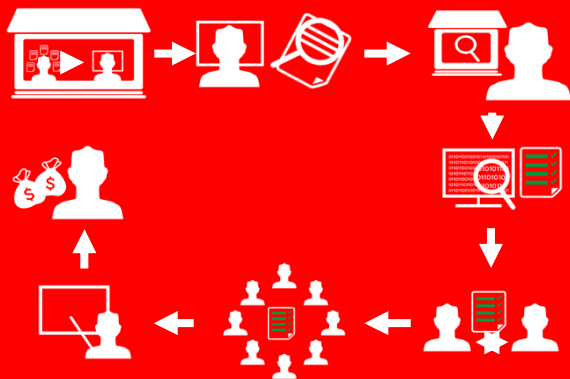
S Sparkassenstiftung für internationale Kooperation

- Common knowledge and training level
- Improved process execution and task application
- Better understanding of financial responsibilities
- Improved NPL ratio

2

STANDARD- IZATION

Loan process is
not followed



Key Finding:

Process and guidelines not lived → issue more strategic

Recommendations:

1. Core banking system across all SACCOs/MFIs
2. Fraud proved checking system for collaterals
3. Continuous internal and external audit process
4. Ease dunning and collection process

Expected outcome:

- Reduction of error rates → reduction of NPL
- Higher utilization and access of collaterals.
- Lower NPL ratio

PRODUCT

Inflexible
product
structure



Loans inflexible in conditions & contract design.

1. Maturity / installments: correlation purpose and match debtors' earnings
2. Interest rate / pricing: consideration of solvency and customer scoring (reward)
3. Inclusion guarantors like BDF
4. Payments: extension of maturity

- Product portfolio to customers needs
- Quality in price calculation, customer reward
- Repayment more reliable → lower NPL

4

SUSTAIN- ABILITY

Missing goal
driven incentive



Key Finding:

No transparent and common reward system with controlled KPIs

Recommendations:

Balance Scorecard incentive:

1. Financial incl. NPL ratio
2. Customer
3. Internal Process
4. Learning and Capacity

Expected outcome:

- Motivated + skilled employees
- Process compliance + optimization
- Improved profits
- High-quality credit portfolio → lower NPLs



SUMMARY

Rwanda is an **ambitious country** with **strong partners** – such as SBFIC – what it needs is improvement in the four key findings areas: (1) Improvement of **Education** (2) Implementation of a solid credit **process with supporting audit** (3) Refresh of **products** with a focus on customers' needs and (4) Motivating **incentives** to lead to sustainable and **performing growth**.



thankful



hopeful



ready to support

Do you have any Questions?



Thank you.
Murakoze.
Vielen Dank.

EMBA Team

Benjamin Hermanns

Ingrid Johnson

Selina Weißer

Fabian Winkler