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The Trends Analysis of Asset and Liability of Micro Finance Banks

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Abstract
Over the years the micro finance banks sub-sector have witness some changes as a result of changes in macroeconomic system which was orchestrated by central bank of Nigeria and global financial crisis. These changes have made the micro financial sub-sector adopt different growth strategies to manage its financial risk to ensure the survival of their firms. The aim of the study is to analyze asset and liabilities of micro finance banks of Nigeria to identify her growth strategy. The study is postulating an asset and liability management growth strategy to promote a diversified funding sources, sound asset and liability management which is critical to posting an excellent performance. Specific objectives achieved: identify growth strategies adopted by Nigeria micro finance banks sub-sector. Identify risks exposed by micro finance banks operating in the sub-sector. Then, suggest the implementation plan of asset and liability management. The study recommended the training of micro finance banks management on asset and liability management techniques.
Key words: Trends Analysis, Asset, Liability, and Micro Finance Bank

1.Introduction

The Nigeria financial systems have been characterized by bubble, boom, and burst which the micro finance banks sub-sector is not an exemption. Over the years this sector has witnessed changes in monetary policies control,reforms in legal, regulatory and supervisory guideline, number of micro finance banks,assets,capital and liabilities.Nevertheless,these positive changes have attracted new firms and led to exist of old ones.

The emergence of commercial banks into micro finance system has deepened the market and increase the level of competition in the sector. This development has increased the outreach of micro financial institution in breath, brought innovative lending method and effective service delivery.

Notwithstanding, these giant strides, the current global financial crisis heralded the scarcity of fund and high cost of funds. This abnormality in the financial system highlights the importance of asset and liability management. This is because when the financial system freezes the micro financial system catches cold. All deposit taking micro finance banks take risk to make money. Therefore, asset and liability management is an appropriate tool to strike a balance between risk and reward.

2. Material and Method

2.1*Concept*

According ledgerwood(1999:254) refers to asset and liability management refers as financial risk management of a financial institution.Generally,any action to increase the expected returns of a micro finance bank will also increase its risk structure. Asset and liability entails understanding those risk and return tradeoffs and making them clear so that the board of directors and senior management can make informed business judgement about the best course for the micro financial institution. The asset and liability management manages the structure of a micro financial banks balance sheet and the risks and return inherent in this structure.

2.2 *Overview of Micro finance bank Performance Evaluation*

As was captured by Nigeria Microfinance Newsletter (2009) the German Technical co-operation (GTZ) carried out a performance evaluation of 24 micro finance banks in Nassarawa, Niger and Plateau States, the result showed absence of prudential strategies of balance sheet management. This is an indication of poor understanding of how to leverage their capital, maintain sound asset and liability. This lack of understanding is also shown in that fact that half of these banks are still yearning for additional funding without recourse to new saving products while the other half which have more fund than they known how to efficiently on-lend would rather leave money in commercial bank money market instrument at sub-optimal levels of returns. Poor understanding of how to efficiently manage balance sheet for growth and sustainability can have severely restraining effects and frustrate efforts to midwife a strong micro finance sector.

2.3*Structure of Asset and Liability Management*

As captured in ledgerwood(1999:255) in formal financial institutions asset and liability management is normally carried out by a committee because it involves both operations management and treasury activities the committee functions involves setting g policies and guidelines to establish the risk tolerance of the organizations. But the policies formulated are ratified by the board of directors. The asset and liability committee meets frequently and determines the lending organizations current position in every risk dimension while also forecasting for all future time periods. If the organisation is currently or expected to be outside of its risk limit, then the asset and liability committee must make a decision as to how to correct the situation. This could involve a change in the structure of the balance sheet to ensure that the level of risk is appropriate or less commonly, a change in the policies and guidelines of the micro financial institutions. Most micro financial institution does not have the depth of financial and operational management to create a committee. Hence asset and liability will likely be carried out by the director and the financial manager of micro financial institution.

2.*4Classification of Financial Risk Exposed by Nigeria Micro Finance Banks*

As outlined by ledgerwood(1999) the major categories of financial risk that a micro finance banks are exposed to are:

1. Credit risk
2. Liquidity risk
3. Interest rate risk

Liquidity risk: As explained by ledgerwood(1999:255) that liquidity refers to the ability of a micro finance banks to meet its immediate demands for cash, that is loan disbursement, bill payments, demand deposit and debt payment. Micro finance banks is in a liquid position, if it is able to meet its current obligations as they become due while a micro finance banks is in an illiquid position if it is unable to meet claims for funds. Liquidity risk refers to the risk of incurring additional expenses for borrowing relatively expensive short-term funds to finance to finance an illiquid position. Liquidity management is the process of ensuring that the demand for funds is readily met without additional borrowing. The goal of liquidity management is to maintain an acceptable level of liquidity management is to maintain an acceptable level of liquidity management is to maintain an acceptable level of liquidity while balancing the need to earn revenue. Too much cash in a branch or head office result in lost income, since idle cash does not result in missed loan disbursement opportunities, delayed bill payment or higher borrowing cost for the micro financial institution (overdraft).

According to Churchill and Coster(2001:65) the key for mitigating liquidity risk is cash flow management. The liquidity indicator most appropriate for institution mobilizing voluntary savingeg.it will need to ensure adequate liquidity to meet client withdrawal request and debt service payment using an indicator such as quick ratio, liquidity ratio and idle funds ratio.

Credit risk: According from ledgerwood(1999:255) is the potential loss resulting from the poor quality of the organization asset, particularly its loan portfolio. It plays a critical role in a micro finance bank expense, cashflow, revenue and profitability. When a micro finance bank is exposed to high credit risk, additional effort is put to collect delinquent loans usually mean additional effort is put to collect delinquent loans usually mean additional expenses for closer monitoring, more frequent visit to borrowers more extensive analysis of the portfolio, legal fees for pursuing seriously delinquent borrowers. The more time effort and resources that are put into controlling delinquency, the less there are available for the micro the micro finance banks to reach new borrowers and expand services or outreach.

Delinquency can result in a slower turnover of the loan portfolio and an ability to pay expenses due to reduced cashflow.if loan principal is not recovered at the schedule time, loans to others borrowers cannot be made and payment of some expenses may also have to be delayed. Also with reduced cashflow, the micro financial institution may be unable to make timely repayment of borrow funds or meet the demand for saving withdrawals.

Delinquent loan result in postponed or lost interest revenue. To determine the amount of postponed revenue resulting from delinquent loans, the interest received in a given period is compared with the expected revenue in the period.

This is done by multiplying the effective yield by the average portfolio outstanding in the period and comparing the result with interest received.

According to churchil and coster (2001:35) credit risk management can be divided into preventive steps lenders take before issuing a loan and use of incentives and incentives after loan disbursement to extract timely repayment. He explained that prior to issuing a loan; a lender reduces credit risk through controls that reduce the potential for delinquency or loss, such as loan product design, rigorous client screening and client orientation to expectation and procedures. Once a loan is issued, a lenders risk management expands from controls that reduce the potentials for loss to controls that reduce actual losses. As such credit risk controls involves; loan product design.2.client screening.3.credit committee.4.delinquency management.churchil and coster(2001:46) highlighted some useful indicator to be used in monitoring portfolio quality ratios which includes loan loss ratio, reserve ratio, loan rescheduling ratio and portfolio at risk.

Interest rate risk: According ledgerwood(1999:251) interest rate risk arises when interest rates on assets and interest rates on liabilities(which fund the asset) are mismatched both in rates and terms. Interest risk occurs after assets and liabilities have been priced or loans have been booked. It should not be confused with pricing loans to cover the micro finance bank cost and expected returns. Interest rate risk is particularly a problem of micro finance banks operating in countries with unpredictable inflation rates, which affects rates on debt. If the interest rates rises, the interest rate on its loan is determined by the degree to which short-term liabilities rate on its loan is determined by the degree to which short-term liabilities are used to fund longer-term loan within the portfolio; in other words

Interest rate risk analysis begins with two main questions

1) What is the amount of funds at risk for a given shift in interest rates?

2) What is the timing of cash flow changes that will be experienced for a given interest rate shift.

It is important to know how large the effect of a change in interest rates will be in present value terms and when the effect will be felt to determine the amount of funds at risk for a given shift in interest rates it is necessary to look at different asset and liabilities of a micro finance bank. Not all assets or liabilities be have same given a percentage change in interest rates. This is referred to as interest rate sensitive, given the lack of alternatives for credit or saving services in the informal sector, a percentage change in interest rates (either credit or saving) will not greatly influence their behaviour. What is important is the availability quality and convenience of services.alternatively, time deposit and large loans are provided to more sophisticated clients who are generally more interest rate sensitive.however, based on the assumption that microfinance serves lower-income clients, we can assume that interest rate sensitivity is for the most part less important to managing interest rate risk than responding to timing of any cash flow shifts.

According to Churchil and Coster (2001 :) the useful indicator for monitoring interest rate risk is the net interest margin commonly called the spread. This ratio calculates the income remaining to the institution after interest is paid o all liabilities and compares the result with either the total asset or the performing assets of the institution. A variation of this ratio is (interest revenue-financial expenses/average assets).

2.5 *Other Growth Strategy for Micro Finance Banks*

As outlined by Olusegun (2008) and Naviasha (2008) the growth strategy adopted by micro finance banks are as follows

Liability management: According to ledgerwood(1999:257)some micro financial institution manage liquidity by establishing a line of credit that is by management the liability side of the balance sheet rather than the asset side(such as cash flow).

In this way cost are incurred only when the credit line is used. This method of liabilities management is only available to micro finance banks that have proven their ability to manage their financial performance and have thus been able to establish a relationship with a commercial bank.

Asset management: According to Brom(2009) traditionally, micro finance banks focuses on the asset side of the balance sheet-the client loan portfolio. This make sense because the core business for most new micro finance banks is lending and it is important that they develop the appropriate products,reports,operations and procedures to support their credit activity and ensure high level of repayment. In their early phases, micro finance banks are normally financed by a combination of grants and concessional funding, so liability management is not as important. But as micro finance banks grow and expand their funding sources to include commercial loan, bond issuance and equity it is important to have to have equally set of reports, policies and procedures for the liability side of the balance sheet.

2.6 *lessons from India micro finance crisis*

In Micro Finance India Summit 2010,the experience from the India micro finance crisis in Andra Pradesh and elsewhere in India pointed to over-indebtedness as a major factor responsible for the crisis which were attributed to repayment stress and taking more loan than they can repay by client on hindsight as was pointed in krishnaswamy(2011). According to Rhyne(2010) the crisis threatens microfinance not only in Andhra Pradesh, but nationwide as the reserve bank of India moves toward removing the priority sector designation that has fuelled the sectors growth(by making it advantageous for banks to lead to micro finance institution. The blame for this unfortunate situation falls most squarely on micro finance institutions that failed to restrain aggressive growth even as the market became increasingly saturated. Investors must also swallow big spoonful blame because they paid dearly for shares in the micro finance institutions. They need fast growth to make their investment pay off.

Rhyne(2010)suggested that deposit-taking micro finance institution should be properly supervised and allowed to raise funds locally, both from clients and others in their neighbourhoods. It will create a balanced portfolio of product and revenue sources rather than exclusive reliance on the micro-loan mono product.Nevertheless, India policies have led to poor governance frameworks for micro financial institutions. In many countries, leading microfinance organisation like Mibanco and Bancosol(Bolivia) were commercialized with a mix of owners including the original non-governmental organization(NGO)international social investors(including development banks)and some local shareholders. The NGOs kept the focus on the mission, while the international social investors contributed a commercial orientation also tempered by social mission.NGOs are prohibited from becoming shareholders rather the supervisory authorities accepted an ownership mix or structure that client ownership would create a grassroots accountability but this actually tampered with corporate governance. This resulted into pioneers of the firms dominating; this is a pattern which affected each of the big three micro finance institutions in Andhra Pradesh and led to a lack of checks on decisions by managers and the entrance of pure commercial players like sequoia capital India with their over-emphasis on fast growth.

2.*7Caution to exercise in implementation of growth strategy by micro banks*

As was captured in Ross(2010) the work of Grameen foundation human capital centre on microfinance institutions around the world which pointed to guide in implementation of growth strategy. It was outlined as follows;

1. The strategy should not focus on short-term performance target: the strategy should not focus on portfolio size, portfolioquality and number of clients because it affects the process of approval and collection of loan from the client.
2. The strategy of the organisation decision making should not be centred at the top management level: the decision making process should be left for operating management level to keep decision making closer to the people who have the most current information on client and local conditions.
3. The strategy focus on the financial return should not be at the expense of social return: micro financial institutions should embrace a balance culture that balance between financial return and social return the essence is to ensure that the saving of client is protected through appropriate decision/actions.
4. The strategy should focus on creating an internal brand: micro finance institution internal brand is measured from the way employees are treated as an important asset of an organisation which is a pointer to its external brand.

3.0. Methodology

The research adopted an analytical approach whereby time series analysis was used to establish the trend in Total Assets and Total Liabilities of micro finance banks. In addition, ratios were used to establish the relationship between variable in the balance sheet of micro finance banks.

4.0. Result of the Research

The study carried out a performance evaluation of 805 micro finance banks in Nigeria, the result showed absence of prudential strategies of balance sheet management

5.0. Discussion of finding

Table I: Indicate that the total deposit grew at average growth rate of 0.516 percent from 2001 to 2010.The deposit mobilisation of micro finance banks grew progressively from 2001 to 2005 but fell in 2006.But after conversion the growth rate was sustained from 2007 until 2010.There was no recourse to new saving product.

Table II: Indicate that the total loans and advances grew at an average growth rate 0.432 percent from 2001 to 2010.The ability of micro finance bank to create money was sustained from 2001 to 2005, but fell in 2006.But after conversion, the growth rate was sustained from 2007 until 2010.This asset variable has proven a veritable source of income for the bank over the year.

Table III: Indicate that the total liabilities grew 2001 to 2010 at average rate of 0.547percent.The total liabilities of micro finance banks were progressive from 2001 to 2010, which is comparable with the total deposit growth rate. It then follows that micro finance banks were adopting less of liability management strategy in meeting the demand deposit of customers. The major component of liability portfolio is the customer demand deposit and grants from donors

Table IV: Indicate that total asset of micro finance banks grew at a growth rate of 0.587percent from 2001 to 2010.The total asset grew progressive from 2001 to 2005, but fell in 2006. The total asset grew again from 2007 to 2010 progressively but the growth was not commensurate with the level of performance. This is due to toxic asset inherited from community banks

Table V: indicate the ratio of total loan to GDP grew at an average growth rate of 0.00683 percent. The ratio grew progressively from 2001 to 2005, but in 2006 it fell. But after conversion in 2007 the growth rate was sustain till 2010.The major flaw is not focusing on targeted group (low income earners).

Table VII: indicate that the performance result grew at a growth rate of 0.003452percent.the performance result grew progressively from 2001 to 2005 but fell in 2006.But after conversion in 2007, the growth rate was sustained till 2009 but fell in 2010.The micro finance banks have not been able to manage the asset portfolio efficiently to maximise the income from it.

6.0. Conclusion

There is poor understanding of how to efficiently manage the balance sheet for growth and sustainability. This has severe restraining effect and frustrating efforts in midwife a strong micro finance sub-sector. Over the years weak risk management practices, and poor corporate have cited among the major causes of bank failures and financial crises in the system.Therefore, as a resultant of changing risk landscape, there is need for effective asset and liability management.

7.0. Recommendation

1. The managing directors, heads of credits and operations should be trained on balance sheet management (asset and liability management) to enhance their skill base.
2. The central bank of Nigeria certification programme should be fast tracked too address the problem of executive capacity.
3. There should be continuing education/capacity building programmes to bridge the observed deficiencies of other staff.

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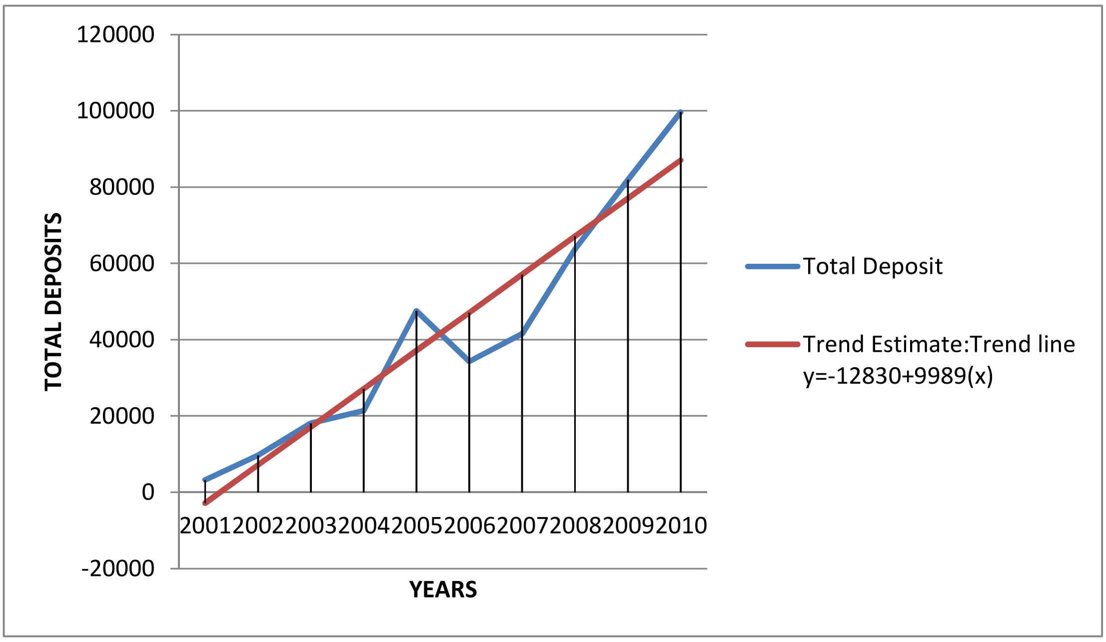
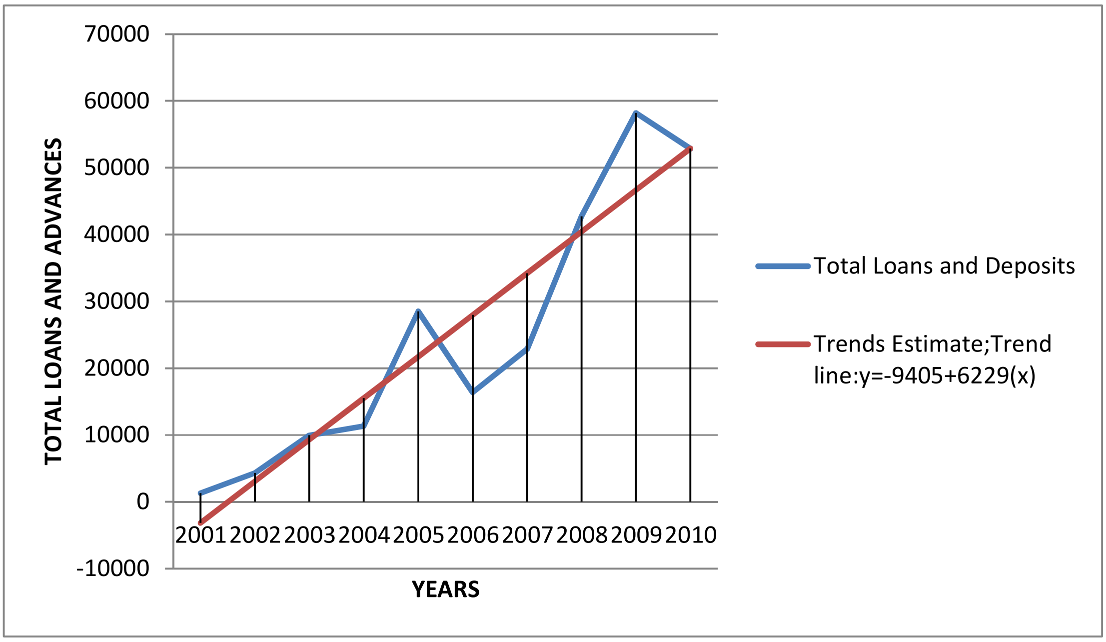
Table I: Time Series Analysis of Total Deposit from 2001 to 2010



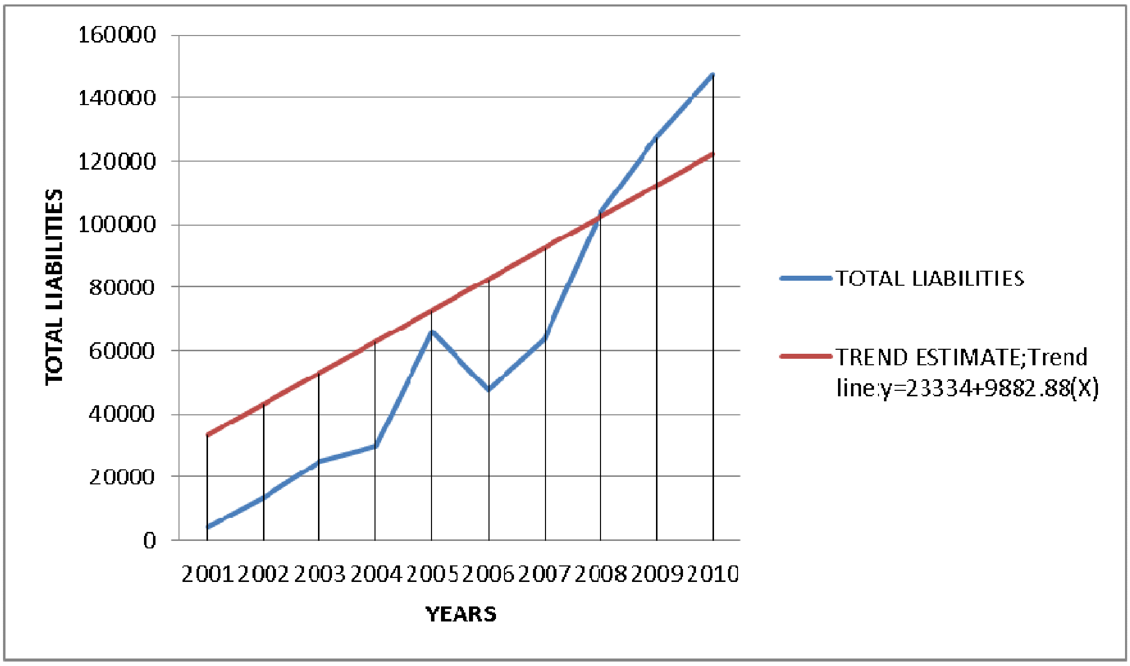
Source: Central Bank of Nigeria

TableII: Time Series Analysis of Total Loans and Deposit from 2001 to 2010



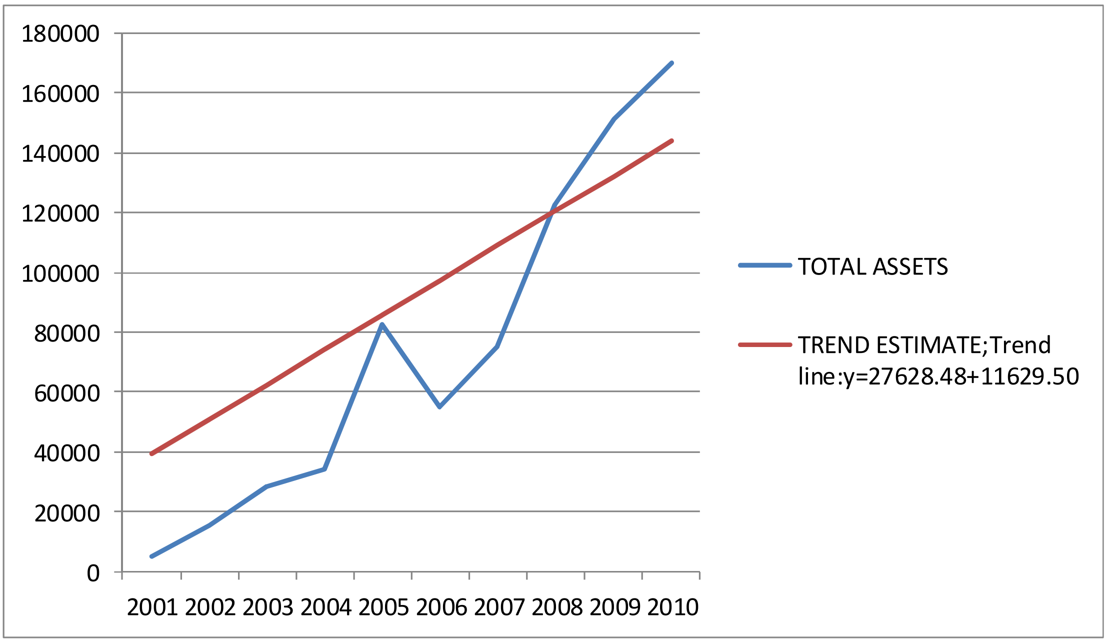
Source: Central Bank of Nigeria

Table III: Time Series Analysis of Total liabilities from 2001 to 2010



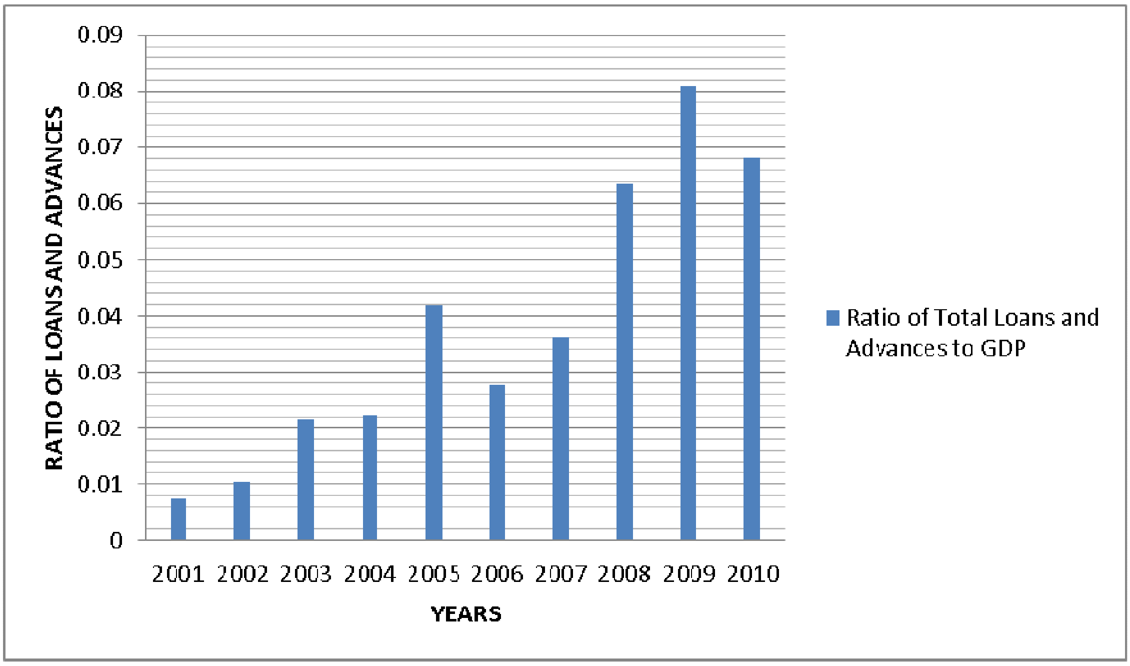
Source: Central Bank of Nigeria

Table IV: Time Series Analysis of Total Assets from 2001 to 2010



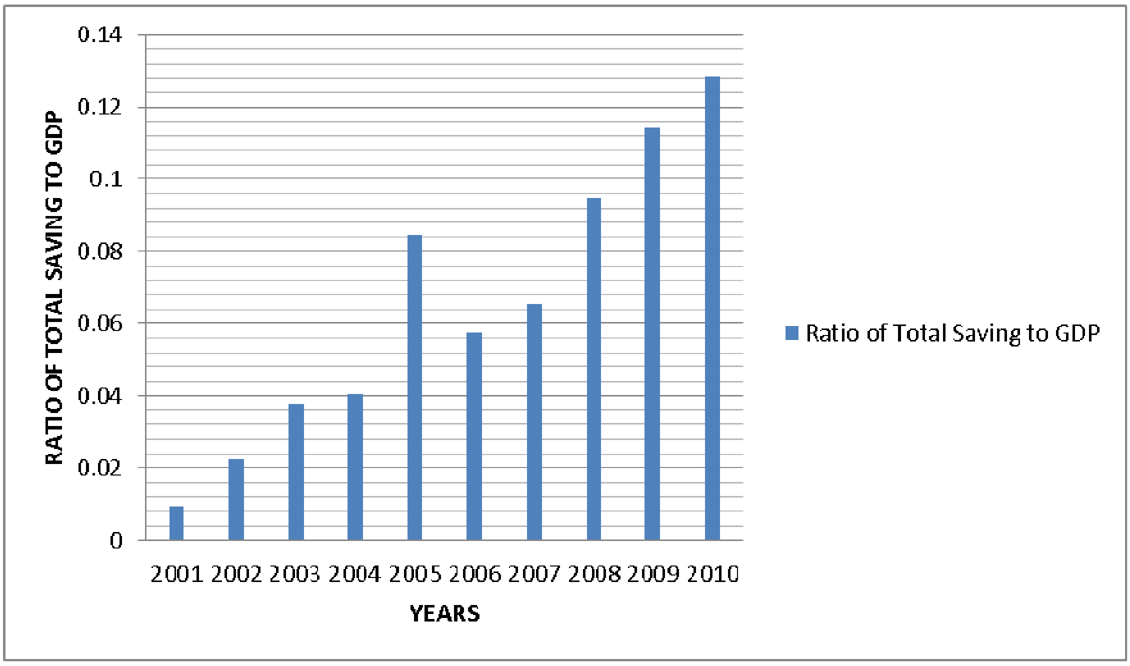
Source: Central Bank of Nigeria

Table V: The Ratio of Total Loans and Advances to GDP from 2001 to 2010



Source: Central Bank of Nigeria

Table VI: The Ratio of Total Saving to GDP from 2001 to 2010



Source: Central Bank of Nigeria

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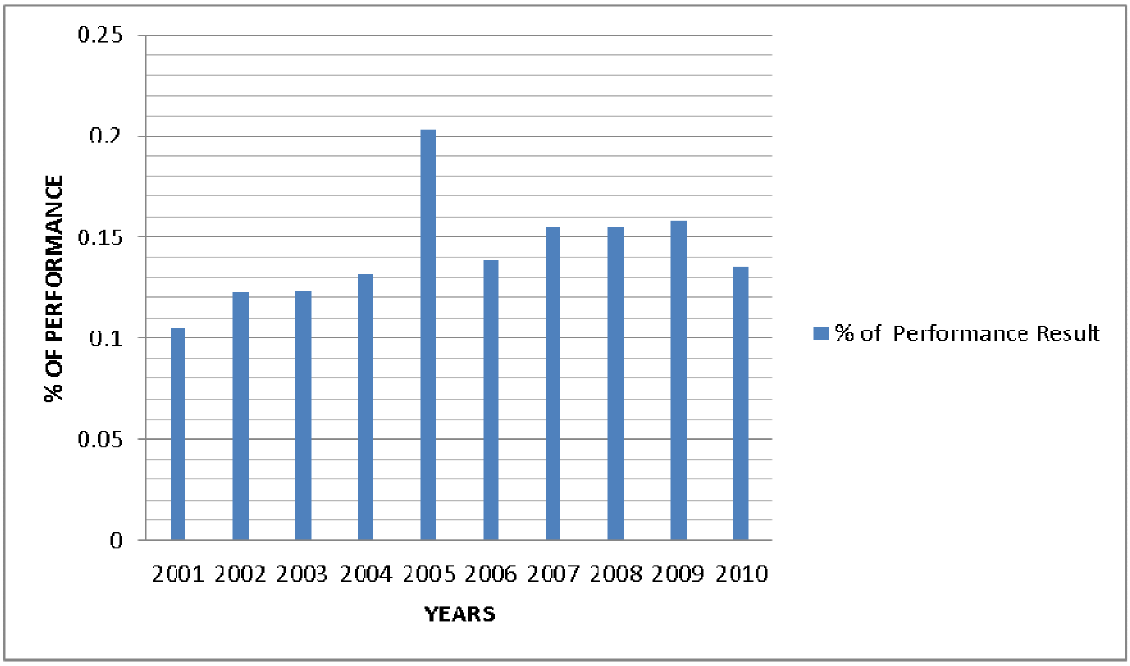
Table VII: Summary of Performance Result of Community banks/Micro finance Banks from 2001 to 2010



Source: Central Bank of Nigeria