# The Assessment of Microfinance Banks' Compliance to Stanley Morgan's International Benchmarks for Microfinance Institutions: A Case Study of Standard Microfinance Bank Limited, Yola, Nigeria

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***Abstract:*** *The study was conducted to determine the level of Microfinance Banks' compliance to Stanley Morgan's International Benchmarks for Microfinance Institutions, the experience of Standard Microfinance Bank Limited (SMFB), Yola, Nigeria. The study exclusively used data from secondary sources, consisting of Standard Microfinance Bank's financial statements and reports. Morgan Stanley's methodology (model) for assessing Microfinance Institutions' Credit Risks performance rating was used to analyze the secondary data collected. The study revealed that SMFB performed below expectation in most of the indicators. Based on the findings of this study, Microfinance Banks (MFBs) are recommended to make Stanley Morgan's Bench mark indicators their guide for day to day operations. This will enable MFBs to be sustainable and easily meet up with the requirements of international investors and donors agencies.*
***Keywords****: Bench marks, Microfinance Banks, Performance Measurement, Indicators,*

## I. Introduction

According to Xavier, R, *et al.* (2008), Microfinance is experiencing an unprecedented investment boom. The recent years have seen remarkable increases in the volume of global microfinance investments. The entry of private investors is the most notable change in the microfinance investment marketplace. New players arrive on the scene every month.

However, this does not come as easy as it seems on paper. Key criteria are considered and certain conditions must be met. The underlying fundamentals of investments such as institutions' Sustainability, Returns on Assets, Operating efficiency, Assets and Liability Management, portfolio quality and productivity remain the key to sustainable investments. This paper therefore discusses the level of compliance to these key indicators by Microfinance Banks in Nigeria and recommend the best way that Microfinance Banks can improve on these indicators so as to continue to attract more investors and donor agencies.

## II. Objective of the Study

To assess the level of compliance of Microfinance Banks to Stanley Morgan's international bench marks for Microfinance Institutions.

## III. Review of Literatures

Microfinance is an effective tool to fight poverty by providing financial services to those who do not have access to or are neglected by the commercial banks and other financial institutions. According to Dokulilova et al (2009), the poor, having no or very little income, cannot offer any collateral which banks require, have no credit history, banks are too far away to verify and observe their behavior (there is little information) and the loans are generally far too small compared to transaction costs. Having defined what Microfinance, we now focus on what other researchers have done in the area of measurement criteria to assess the performance of Microfinance banks

Yaron (1992) recommended two primary measurement criteria to assess the performance of Microfinance banks. First criterion, outreach, which assess the financial service (the output of the intervention) that provide the Microfinance banks to poor customers, given the goal it was founded to attain and for which fund is provided. The second criterion is the Subsidy Dependent Index (SDI) that measures that level of Microfinance bank subsidy dependency, this framework of outreach-SDI was generally accepted and used by many researchers (Nanayakkara, 2012, Manos, R., and Yaron J., 2009, Schreiner, M.J. 1997).

Hulme, D., (2000) reviewed the methodology options for assessing the impacts of MF programs. He explores methods to enhance impact assessment (IA) practice. Hulme argued that while all studies must pursue rigor, the effectiveness of an IA will depend on how it's good in achieving a fit between its objectives and its

context. However, very often, donor desires for objective and outside IAs lead to weakening the impact monitoring capacity of the Microfinance bank itself.

Navajas, S., *et al.* (2000), constructed a theoretical framework that define the social worth of an Microfinance banks in terms of the depth, worth to users, cost to users, breadth, length and the scope of its output. The majority of the poor households served by the Microfinance banks were near the poverty line. Individual lenders had less depth of outreach then group lenders. The study concluded that the poorest borrowers were more likely to be the rural borrowers, but most of the borrowers were more likely to be the urban poor.

Arsyad, L. (2005) used the following indicators in his research to measure the strength of some MFIs: portfolio quality, leverage capital adequacy ratio (CAR), productivity, efficiency, profitability, self-sufficiency and outreach. He assessed and concluded that these indicators from both formal and informal institutions has a greater influence on the sustainability and outreach of any MFI.

Neitoa, B.G *et al.* (2005), used a data envelopment analysis (DEA) approach to measure the efficiency of Microfinance banks. Microfinance banks efficiency can be explained by means of four principal components of efficiency, each component related to a very different issue: overall efficiency, Non-Governmental Organization (NGO) status, input choice and output choice. This can explain the reason why microfinance bank achieves a level of efficiency under a given specification.

Abbas, *et al.* (2013), stated that a growing acceptance of standards for microfinance has emerged since the early 1990s. In 2002 a Microfinance Financial Department Guideline was developed jointly by microfinance banks, the SEEP Network, rating firms and donor agencies. This Framework built on consensus and includes definition of selected Financial Terms, Ratios and Adjustments for Microfinance. The Framework was intending to provide microfinance practitioners with a means to develop financial reporting in accordance with International Financial Reporting Standards (IFRS). The authors argued that this Framework will help microfinance banks' managers in monitoring and decision making process. The Shortcoming of this framework, is that it does not include the standards for measuring deposit taking Microfinance banks, nor does it include any set of social performance indicators (SEEP, 2006).

Engels, P., (2010), Stated that policymakers, investors and competitions among Microfinance banks and between commercial banks encourage the importance of Microfinance banks financial performance measurement. He revealed some financial performance measures and referred to recent involvement of specialized rating agencies in social performance. He also criticized the social performance standards published by Social Performance task Force, in that their categories are broader and uncertain about data availability and subjectivity in prioritizing indicators of social performance. Also he reported that average loan size measure is used as their primary indicator for the social performance of Microfinance banks in spite of criticisms by many authors.

Bakhtiari, S., (2011), revealed that a number of performance indicators have been presented and many of them have become standardized. Abbas, K., Ahmed, M., and Maisarah, M (2013) stated that in 2003, a consensus group composed of microfinance rating agencies, donors, multilateral banks and other private voluntary organizations agreed to some guidelines on definitions of financial terms, ratios and adjustment for microfinance.

Oguntoyinbo (2011), conducted a similar research on credit assessment of Accion Microfinance Bank Limited and found out that sound and qualitative credit risk assessment leads to low credit risk and high profitability for MFBs.

In all these studies, the work done were more of theoretical aspect than practical. The areas of Microfinance Bank' performance using key indicators in line with the International benchmarks were not covered. Our research has bridged this gap. Field survey was undertaken to assess the level of compliance of Nigerian Microfinance Banks to international benchmarks. In this regard, our paper is quite distinct from others and it gives insights into the performance of Microfinance Banks in Nigeria.

## IV. Materials and Methods

**4.1 Study Area:**

Yola is the administrative capital of Adamawa State of Nigeria. It is a twin settlement consisting of Jimeta -administrative and commercial center, and Yola Town - the traditional settlement. Yola is located on latitude 9°14″ N and longitude 12°28′ E. It has total land coverage of 662.47 square kilometer. Yola has a tropical climate marked by rainy and dry seasons. The maximum temperature can reach 40C particularly in April, while minimum temperature can be as low as 18 °C between December and January (Asongo A.I and Idama, 2014).

**4.2 Data Collection**

The study exclusively used data from secondary sources (see Table 2), consisting of Standard Microfinance Bank's financial statements and reports. Specifically, the following documents were used SMFB; Annual audited Accounts from 2007 to 2013; SMFB Credit Manuals and the corporate profile of SMFB.

**4.3 Method of Data Analysis**

Morgan Stanley's methodology (model) for assessing Microfinance Institutions' Credit Risks performance rating was used to analyze the secondary data collected. This process consists of five steps, described as follows:

**Step 1:** Data on the quantitative risk factors collected from the financial statements and reports of SMFB were analyzed into 11 ratios labelled A1 to C3 described in Table 1. The ratios or indicators concerned were computed over a Seven-year period, from 2007 to 2013.

**Step 2:** After computing the indicators, they were graded on a rating scale of 1 to 6, with 6 indicating excellent and 1 indicating poor, respectively.

**Step 3:** The results (indicators for the Seven years) were compared over time to observe the performance trend, to find out whether SMFB performance had improved or declined.

**Step 4:** The average of the risk indicators were computed over the Seven-year period, and the results compare with Morgan Stanley's benchmark to yield a kind of comparative global performance.

**Step 5:** The results obtained from our research work (Table 3) were compared against the Morgan Stanley's benchmark shown in table 1. Our comments and recommendations on the credit performance of Standard Microfinance Bank were based on the comparative results obtained.

# V.  Results and Discussions

The research result is hereby discussed line by line from A1 to C3 using Table 3.

**A1: Portfolio at Risk (PAR)**

The Portfolio at Risk ratio measures the potential for future losses based on the current performance of the portfolio. It is the most widely accepted standard and ratio of portfolio performance in Microfinance Banks. Loans delinquent for up to 30 days generally have high potential of being collected, with the appropriate management approach. The reverse is the case when the PAR > 30 days is high.

In 2007, Standard Microfinance Bank had 26.21% PAR >30 days which is far above Morgan Staley's <3% benchmark indicating a very poor loan portfolio quality. The Bank recorded lowest portfolio at risk of 9.12% and 9.10% in 2008 and 2010 respectively. The decrease in the PAR >30 was an indication of an improvement in the Bank's recovery effort, even though the portfolio quality still fell below the best grade of <3%.  However, the portfolio at risk went up again in 2009, 2011, 2012 and 2013 as the recovery effort declined.

**A3: Size of Portfolio**

Standard Microfinance Bank's loan portfolio increased rapidly from N72,688 million to N128,043 million between  2007 and 2009. The figure then declined slightly from N128, 043 million to N103, 956 million in 2010 and 2011 respectively. The loan portfolio size picked up considerably from 2012 to 2013 , marking an increase of 67.17%. The growth in loan portfolio of Standard Microfinance Bank was mostly due to the increase in the number of active borrowers .

**A4: Loan Loss Reserve**

A loan loss reserve of over 85% is considered excellent by Morgan Stanley Standard. Going by the benchmark, Standard Microfinance Bank made inadequate loan loss provision in 2007, 2011 and 2013.However, the Bank had high loan loss reserve of 95.8% in 2008, 92.44% in 2009, 112.67% in 2010, 100.91% in 2012 and 90.06% in 2013, which indicated that there was adequate provision to cover the anticipated loan losses in these years.

**B1: Sustainability**

Sustainability ratio measures the ability of a Microfinance Bank Ltd to cover its operating expenses, its loan loss provision, and loan write-offs, and yet remain buoyant. The sustainability ratio of >120% is considered excellent, while a ratio of below 90% is considered very poor.

The sustainability of Standard Microfinance Bank from 2007 to 2013 was excellent as shown by the indicator of 154% in 2007, 180% in 2008, 126.9% in 2010 and 122% in 2013. The ratios are above Stanley Morgan's benchmark of 120%. However, as business increased in 2009, 2011, 2012 and 2013 the sustainability declined to 93.4%, 96.2%, 100% and 106.2% respectively yet within acceptable benchmark. Overall, the Bank is sustainable as shown in the ratios.

**B2: Return on Average Assets (ROAA)**

A Return on Average Assets is an indication of how well a Microfinance Bank is managing its asset base to maximize profits. The ratio evaluates the return of the portfolio and other revenue generated from investments and operations. Morgan Stanley benchmark for this ratio ranges from >3% (Excellent) and -2 % (very poor). Standard Microfinance Bank made a negative return of -15% on its average assets in 2011 indicating a very poor result in that year. However, the ROAA was ranked 'good' as the Bank recorded 4% in 2007, 6.3% in both 2008 and 2013, 3% in 2009, 2.6% in 2011 and 2012. In order to maintain the impressive ROAA ratio, Standard Microfinance Bank must continue to maximize its profit by ensuring continuous growth in its net income as its assets increases.

**B3: Operating Efficiency**

Operational Self-Sufficiency measures the degree to which internally generated operational revenue covers all operating expenses from the Microfinance Bank's core business of providing financial services. Operational efficiency is considered excellent when the ratio is less than 20% and rated very poor when the ratio is above 50%.

The efficiency ratio of Standard Microfinance Bank was rated excellent in 2007 and 2008 as the Bank recorded ratios of 11.8% and 8.7% respectively. The impressive performance in 2007 and 2008 could be attributed to a gradual economic scale which occurs when an organization's operating expenses decline as its business grows. However, the operating efficiency declined between 2009 and 2013 as the Bank's expenses increased. The year 2011 was the poorest as the bank recorded 31.5% of operating efficiency ratio.

**B4: Productivity.**

This ratio reflects the productivity of loan officers in serving their client caseload. The higher the caseload per officer, the more clients will be served, and the greater the efficiency gained. The highest grade according to Morgan Stanley's scale is 200 borrowers per staff member while the lowest ratio is less than 130 borrowers per staff. Standard Microfinance Bank Ltd recorded a very poor productivity with 78 borrowers per staff in 2007, 70 borrowers per staff in 2008 and 124 borrowers in 2010. However, there was a remarkable improvement from 2011 to 2013 as the Bank moved from poor productivity to a good performance having 171 borrowers per staff in 2011, 183 borrowers per staff in 2012 and 187 borrowers per staff in 2013. The management have a great task to ensuring that the increase in productivity of the staff does not result to inefficiency. This is because presumably if one employee were to work with many borrowers, doing so would lower his effectiveness which would in turn result to greater loan loss (higher credit risk).

**C1: Leverage**

The Leverage or Debt to Equity ratio is a common measure of a Microfinance Bank's capital strength or adequacy at a particular point in time. Equity is important because it is an indication of internal strength and the capacity to absorb some stress and losses before creditors are at risk. Morgan Stanley considers the leverage of a company to be excellent if it falls below 5% and very poor if it goes beyond 9%. Standard Microfinance achieved excellent result throughout the years having recorded leverage ratio of 4% in 2007, 3% in 2008, 2% in 2009 and 2011 then 1% in 2010, 2012 and 2013. This was a clear indication that the Bank is adequately capitalized. It also shows that the Bank can widen its outreach without being financially stressed.

**C3: Liquidity**

The Liquidity Ratio measures the Bank's adequacy of cash to pay short-term liabilities to lenders, depositors and other creditors. A low liquidity ratio is a signal of liquidity problems in the system, indicating serious challenge in meeting current payment obligations while a very high liquidity ratio might implied ineffective cash management. Morgan Stanley put the liquidity ratio of MFIs to be very good if the ratio is less than 15% and it is worst (with a grade of 6) if it is less than 3%.

For Standard Microfinance, the liquidity ratio was very high in 2007, when it recorded a percentage of 1,149, implying poor cash management, as the liquid assets were not put into profitable use. The situation could also, however, have resulted from the Bank being too careful in that it was trying to study and understand the credit market well during transition from Community Bank to Microfinance Bank. Standard Microfinance Bank's liquidity ratio declined considerably to 72.07% in 2008, as the total loan portfolio rose substantially. In 2009, liquidity declined further to 39.3%. The ratio went up again between 2010 and 2012, signifying lapses in liquidity management before falling again to 37% in 2010. The relatively high liquidity ratio implied that Standard Microfinance Bank was not likely to experience serious payment constraints, however, the Bank should explore other areas to better utilize its funds more profitably in the future.

## VI. Conclusion

Stanley Morgan Bench mark indicators should be a guide for the day to day operation of any microfinance bank. The research revealed that for Microfinance Banks to perform satisfactorily to meet up with international investors and donors requirement, appropriate risks management principles must be adopted in their everyday operations.

## VII.    Recommendations

Based on the findings of the current research, the following recommendations are made for policy adoption:
  i.   Regular Credit risk assessment and analysis should be undertaken, preferably monthly or quarterly by the management of SMFB, as this is a continuous process rather than a once in a while exercise.
 ii.   Efforts should be made by the management of MFBs to reduce its credit risk by approaching recovery aggressively.
iii.   MFBs should adopt measures to lower operating cost in order to meet up with the operating efficiency ratio
 iv.   Competent staff should hired, trained and given target to be achieved, this will increase staff productivity.
  v.   Diverse strategies should be adopted by MFBs to mobilize deposit in order to solve liquidity crisis

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## List of Tables.
### Table 1: Morgan Stanley's methodology for analyzing MFI Credit Performance and Rating

| RATING FACTORS | INDICATOR DEFINATION | Grades | | | | | |
|---|---|---|---|---|---|---|---|
| | | 6 | 5 | 4 | 3 | 2 | 1 |
| Loan Portfolio | A1: PAR = (Outstanding loans with arrears over 30 days + Restructured loans)/Gross Loan Portfolio | <3% | <6% | <9% | <12% | <15% | Above 15% |
| | A2: Write-offs = Total Loan Write –offs over the last twelve months/Average gross loan portfolio | <2% | <3.5% | <5% | <7% | <10% | above10% |
| | A3:  Size of portfolio = Gross loan portfolio | >300M | >250M | >100M | >50M | >10% | less than 10M |
| | A4: Loan Loss Reserve = Loss reserve/PAR30 | >85% | >75% | >65% | >60% | >55% | below 55% |
| Profitability, Sustainability, Operating Efficiency | B1: Sustainability = Operating income/(Financial Expenses + Loan Loss Provision +Loan Write-offs + Operating Expenses. | >120% | >115% | >110% | >100% | >90% | below 90% |
| | B2: ROAA = Net Income/Average Assets | >3% | >2% | >1% | >0% | >-2% | below -2% |
| | B3: Operating efficiency = Total Operating expenses/Average gross loan portfolio | <20% | <25% | <30% | <40% | <50% | above 50% |
| | B4: Productivity = number of borrowers/Total headcount | >200 | >190 | >170 | >145 | | >130 below130 |
| Asset and liability management | C1: Leverage = Total Liability (Net worth +Subordinated debt) | <5x | <6x | <7x | <8x | <9x | above 9x |
| | C2: Foreign Currency Exposure = (Foreign Currency debt)(Total Financial debt) | <15% | <20% | <35% | <50% | 65% | above 65% |
| | C3: Liquidity = (Cash + Short term Investment)/Gross Loan Portfolio | >15% | >12% | >9% | >6% | >3% | below3% |

Source: Oguntoyinbo, 2011

**Table 2:** Morgan Stanley's Credit risk data for Standard Microfinance Bank Ltd.

| Factors | | Indicators | | Data collected | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Sign | Definition | Variables | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Loan portfolio | A1 | PAR>30 days | Outstanding loan over 30 days (N'M) | 19,055 | 7,587 | 16,979 | 9,463 | 21,096 | 45,860 | 60,931 |
| | | | Reschedule /Restructured loan (N'M) | NA | NA | NA | NA | NA | NA | NA |
| | | | Total gross loan portfolio(N'M) | 72,688 | 83,220 | 128,043 | 103,956 | 120,452 | 151,047 | 191,223 |
| | A2 | Write-off | Total write-off over last 12 months (N'M) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | | | Average loan portfolio (N'M) | 72,688 | 114,298 | 147,242 | 180,021 | 164,182 | 195,976 | 246,659 |
| | A3 | Size of portfolio | Gross loan portfolio (N'M) | 72,688 | 83,220 | 128,043 | 103,956 | 120,452 | 151,047 | 191,223 |
| | A4 | Loan loss | Loan loss reserves (N'M) | 2,707 | 7,240 | 15,695 | 10,662 | 11,776 | 46,276 | 54,876 |
| Profitability, Sustainability, Operating, Efficiency, Productivity | B1 | Sustainability | PAR>30 days (N'M) | 19,055 | 7,587 | 16,979 | 9,463 | 21,096 | 45,860 | 60,931 |
| | | | Operating income (N'M) | 16,962 | 31,064 | 42,701 | 62,882 | 61,070 | 97,086 | 113,406 |
| | | | total expenses | 8,291 | 9,939 | 30,194 | 38,885 | 51,697 | 50,664 | 51,833 |
| | B2 | ROAA | Net income (N'M) | 4,484 | 11,566 | 7,044 | 8,551 | (76,453) | 14,903 | 38,351 |
| | | | Total assets (N'M) | 113,452 | 141,447 | 182,126 | 293,331 | 377,139 | 379,766 | 458,833 |
| | | | Average assets (N'M) | 113,452 | 184,176 | 232,510 | 328,791.50 | 481,901 | 567,022 | 609,183 |
| | B3 | Operating efficiency | Total operating expenses (N'M) | 8,291 | 9,939 | 30,194 | 38,885 | 51,697 | 50,664 | 51,833 |
| | | | Average gross loan portfolio (N'M) | 72,688 | 114,298 | 147,242 | 180,021 | 164,182 | 195,976 | 246,659 |
| | B4 | Productivity | Numbers of borrowers (Units) | 1,484 | 1,884 | 3,532 | 5,814 | 7,705 | 8,219 | 9,700 |
| | | | Total headcount (No. of staff) | 19 | 27 | 22 | 47 | 45 | 45 | 52 |
| Assets and liability management | C1 | Leverage | Total liabilities (N'M) | 89,097 | 105,526 | 117,563 | 122,476 | 234,309 | 185,398 | 240,585 |
| | | | Net worth (N'M) | 24,355 | 35,921 | 64,562 | 170,854 | 142,829 | 194,368 | 218,247 |
| | C2 | Exposure to foreign exchange | Subordinated debt (N'M) | NA | NA | NA | NA | NA | NA | NA |
| | | | Financial debt in non-hedged forex (N'M) | NA | NA | NA | NA | NA | NA | NA |
| | C3 | Liquidity | Total financial debt (N'M) | NA | NA | NA | NA | NA | NA | NA |
| | | | Cash (N'M) | 54,112 | 55,645 | 47,828 | 159,403 | 93,279 | 90,567 | 70,698 |
| | | | Short-term investment (N'M) | 781,600 | 4,330 | 2,269 | 12,269 | 102,269 | 167,228 | 221,228 |
| | | | Gross loan portfolio (N'M) | 72,688 | 83,220 | 128,043 | 103,956 | 120,452 | 151,047 | 191,223 |

Source:    Standard Microfinance data obtained from field survey 2014.

**Table 3:** Morgan Stanley's credit risk indicators computed for Standard Microfinance Bank Ltd.

| Factors | | | Data collected | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Sign | Definition | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Average |
| Loan portfolio | A1 | PAR>30 days (%) | 26.21 | 9.12 | 13.26 | 9.10 | 17.51 | 30.36 | 31.86 | 19.63 |
| | A2 | Write-off (%) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | A3 | Size of portfolio (N'M) | 72,688 | 83,220 | 128,043 | 103,956 | 120,452 | 151,047 | 191,223 | 121,518.43 |
| | A4 | Loan loss reserve (%) | 14.21 | 95.43 | 92.44 | 112.67 | 55.82 | 100.91 | 90.06 | 80.22 |
| Profitability, Sustainability, Operating, Efficiency, Productivity | B1 | Sustainability (%) | 154.23 | 180.83 | 93.05 | 126.91 | 96.21 | 100.15 | 106.28 | 122.52 |
| | B2 | ROAA (%) | 4.0 | 6.3 | 3.0 | 2.6 | -15.9 | 2.6 | 6.3 | 1.27 |
| | B3 | Operating efficiency | 11.4 | 8.7 | 20.5 | 21.6 | 31.5 | 25.9 | 21.0 | 20.08 |
| | B4 | Productivity (Number) | 78 | 70 | 161 | 124 | 171 | 183 | 187 | 138.9 |
| Assets and liability management | C1 | Leverage (%) | 4 | 3 | 2 | 1 | 2 | 1 | 1 | 1.83 |
| | C2 | Exposure to foreign exchange (%) | NA | NA | NA | NA | NA | NA | NA | NA |
| | C3 | Liquidity (%) | 1149.72 | 72.07 | 39.13 | 165.14 | 162.35 | 170.67 | 37.09 | 256.59 |

Source: Standard Microfinance figures computed from field survey, 2014