

# smart notes

## Putting the Principles into Practice

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**Responsibility for avoiding over-indebtedness** rests with both clients and institutions. For clients, this means making prudent decisions and judging their repayment capacity. For institutions, this means carefully assessing a client's ability to repay.



*Partner Micro-credit Foundation promotes itself as its clients' "partner for a better life."*

Lending in a highly competitive microcredit market, Partner Microcredit Foundation avoids client over-indebtedness by recognizing that a risk for the client is a risk for the institution. To mitigate these risks, Partner performs rigorous credit analysis of its clients before issuing a loan and follows up with audits to verify proper staff behavior and discover why clients are not able to meet their obligations. Proactive measures like financial-literacy programs and client-loyalty efforts complement analysis and audits to create a robust system to avoid client over-indebtedness.

## Facing Over-indebtedness at Partner Microcredit Foundation

In a vibrant and competitive microfinance sector, Partner Microcredit Foundation employs a multi-faceted system to prevent, detect, and correct over-indebtedness among its clients. Management views avoiding client over-indebtedness as an institutional responsibility and has built a robust system that functions throughout the lending process.

Partner was started by Mercy Corps in April 1997 as a non-profit organization with a long-term goal of establishing a microcredit company to eventually transform into a bank. As of 2009, the institution has 54,572 active loans in a nearly \$100 million portfolio.

### OPERATING IN AN OVERHEATED MARKET

Since 2007, managers at Partner have expressed increased concern about over-lending in the Bosnian market and the threat of a financial market crisis. They recognize that financial institutions and their practices bear the burden of responsibility for current client debt levels.

Partner has chosen to take on the over-indebtedness challenge with a simple philosophy: a risk for the client means a risk for the institution. Management has worked to integrate this philosophy into a strong organizational culture that already values excellent professional services and client satisfaction, while building the systems and procedures necessary to support this integrated approach.

### RIGOROUS ANALYSIS AND APPROVAL

Avoiding over-indebtedness begins with the earliest client interactions. Risk management during the loan-application process requires a number of analyses beyond just a guarantor requirement.

Loan officers conduct a business analysis during the application process, which includes field visits to the client's place of business and consists of diagnostics like a cash flow analysis and income projections. All



clients must also officially prove their income levels through salary confirmations or by showing business agreements with their partners.

Loan officers check clients, guarantors, and even spouses with credit bureaus. There are two credit bureaus in Bosnia-Herzegovina: one private bureau and another one established by the Central Bank. Partner checks with both bureaus to ensure that it does not miss any information. Partner pays for these checks instead of adding them to clients' application fees.

A credit committee consisting of the branch manager and loan officers reviews each loan application. More experienced loan officers use this opportunity to advise junior staff members on the credit approval process.

### **FOLLOW-UP WITH BORROWERS**

After loans have been made, the internal audit department is tasked with detecting lending practices that violate Partner policy or could increase client over-indebtedness. Internal auditors regularly visit all branches and use a random sampling technique to select clients to interview from each branch.

Auditors visit two groups of clients, selected at random: the first group of clients includes all types of clients, while the second sample is selected from delinquent clients only. Each client responds to a detailed questionnaire that auditors use to detect procedural violations by loan officers. The questionnaires also solicit general information on household debt levels. By focusing specifically on delinquent clients, auditors can determine if and how Partner employees may have contributed to client over-indebtedness.

## FINANCIAL LITERACY KEY FOR EMPLOYEES AND CLIENTS

In 2009 Partner's entire staff received financial education from the Microfinance Centre (MFC), a regional network that serves Europe and Central Asia. This education serves two purposes. First, employees use the knowledge to make smarter financial decisions for themselves, their families, and their friends. Over time, Partner has seen that improved financial literacy prompts its staff to open savings accounts and manage their money more efficiently.

Second, Partner employees draw on their own personal experiences to advise clients how best to use financial tools like savings, credit, and income generation to achieve their goals. Because Partner ensures that its employees are financially savvy, they are able to put themselves in their clients' positions to help them make smarter decisions.

Additionally, Partner distributes pamphlets to educate clients on a variety of topics, including: What is interest and how is it calculated?

- Business loans vs. consumer loans
- Hidden costs of credit
- Guarantor responsibilities and obligations
- What is "credit history"?
- Protecting your personal information
- Consumer protection

## KEEPING CLIENTS CLOSE

At Partner, client loyalty is an additional means to prevent over-indebtedness. While Partner can implement practices to prevent over-indebtedness within the institution, it cannot control its competitors' actions. Partner believes keeping clients satisfied and loyal decreases the likelihood that they will seek credit from other institutions, allowing the MFI to maintain better control of clients' levels of indebtedness.

## QUESTIONS FROM THE CLIENT QUESTIONNAIRE

- Did the loan officer visit you before loan disbursement?
- Who are the guarantors of your credit?
- Did you personally sign the contract?
- Did you personally collect the loan disbursement?
- Have you been using the loan yourself or jointly with other people?
- Did you have to pay any charges besides the loan fee and installment?
- What was the purpose of the loan? What did you invest money in?
- What problems are you having repaying the loan (if not repaying on time)?
- Does anyone in your household have other loans from Partner? For how much?

Partner achieves client satisfaction in part by offering a diverse range of products. The institution ensures product suitability through careful product design and testing with the target market. Market research plays an important role and is carried out through a system of customer satisfaction surveys, product testing, client exit monitoring, and mystery shopping. All managers within the institution have a responsibility to ensure service excellence during any visit to the field.

## LESSONS LEARNED

Main lessons learned through Partner's experience include:

- Guarantee requirements should be complemented by a solid assessment of clients' repayment capacity.
- Internal audits can help managers discover and understand client over-indebtedness challenges.
- Financial education is a good investment in over-indebtedness prevention; simple and cost-effective solutions can have a big impact.
- Diversified product offerings allow for better alignment of products to clients' needs, preventing over-indebtedness.
- Keeping clients' needs at the center and recognizing their importance for the MFI drives institutional success.
- A supportive organizational culture is vital to successful client protection.

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For additional information contact Selma Jahic at [selma@partner.ba](mailto:selma@partner.ba).

By: Ewa Bankowska

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## HOW PARTNER AVOIDS CLIENT OVER-INDEBTEDNESS

1. Promotes an institutional philosophy that recognizes a client risk as an institutional risk.
2. Engages in thorough borrower analysis, including field visits, business diagnostics, and checks with credit bureaus.
3. Encourages learning and sharing of experiences among credit staff members.
4. Empowers internal audit to detect policy violations with reviews and branch visits.
5. Includes the client perspective on institutional behavior through surveys, focus groups, and other methods.
6. Promotes financial literacy among staff and clients through training opportunities and informational materials.
7. Encourages customer loyalty by addressing client needs and responding to feedback.
8. Invests in knowing its market to ensure that products are appropriate for it.



Keeping clients first  
in microfinance