

ICPAK WORKSHOP BEST WESTERN HOTEL



MAXIMIZING SHAREHOLDERS VALUE

THROUGH DEFAULT MANAGEMENT

MAXIMIZING SHAREHOLDERS' VALUE THROUGH DEFAULT MANAGEMENT



SHAREHOLDER VALUE

Is a business term sometimes referred to as shareholder value maximization which implies that the ultimate measure of a company success is the extent to which it enriches shareholders.

INTRODUCTION



- Attaining shareholder value is determined to a large extent by how well the Board and Senior Management are able to identify & mitigate various risks that threaten organizational success.
- Risks & exposures pose a direct threat to shareholder value

INTRODUCTION CONT'D



As a Board member or as a Senior Manager

- What are the Risks & Exposures facing your SACCO?
- What are the red flags?
- Have you instituted a system of identifying these risks?
- What are the key mitigating strategies that should be instituted?
- What exactly is your role?

MAXIMIZING SHAREHOLDERS' VALUE THROUGH DEFAULT MANAGEMENT



- AGENDA
- Basic knowledge of Delinquency that is crucial in a SACCO
- Tools at the disposal of the management used to manage Delinquency
- How to employ these Tools to manage Delinquency and the likely impact on organizational profitability and ultimately on shareholder value

PART A: CRUCIAL DELINQUENCY KNOWLEDGE



- Define delinquency Explain the causes of delinquency
- Analyze the impact of delinquency on shareholders' value

DEFINITION



Meaning of Delinquency

A delinquent loan means any loan which the principal or interest remains unpaid after due date

Sacco Societies Regulations 2010

DEFINITION



Calculation of Delinquency

- One-off loan payment shall be deemed to be delinquent if the total principal balance and/ or interest are not serviced at their due date.
- The entire principal balance shall be deemed delinquent even where the missed payment was for interest only.

Sacco Societies Regulations 2010

LOANS AS THE SINGLE LARGEST ASSET



IMPACT OF LOAN DELINQUENCY

- Loans to members make the largest single asset
- Loans are made from members' deposits (liability)
- Loans form largest earning asset
- Hence Loan portfolio quality must be a **PRIORITY** for a safe and sound SACCO
- Loan delinquency affects the stability of any Sacco

CASE STUDY



Uvumilivu SACCO Sacco has applied for a 20 million loan from their bank to grant normal loans to her members which loan has been declined.

They have an average monthly loan portfolio of Ksh.200m. They have a membership 20,000 who have patronized the loan service. The amount in default is 20m.

The Sacco is not computerized and can only afford to employ 3 members of staff in the loans department. The Sacco gives out normal loans and this year they managed to post 10 million loan interest income.

They have invested Kshs 90 million in a building in Kinango town which earns them Ksh .5 m in form of rent.

They need money to give to members and have no business sticking to banks that can't help them. You are a newly appointed Audit Manager of the SACCO. Please advice the Board

CAUSES OF DELINQUENCY



Internal causes of delinquency

Leadership (Board)

- Poor business plans (A formal statement of business goals, reasons they are attainable and plans for reaching them)
- Poor organizational structure (defines how activities e.g task allocation, co-ordination are directed towards the achievement of the organizational aims)
- Lack of proper policies
- Mismanagement of the organization (insider credit abuse)

CAUSES OF DELINQUENCY



Internal causes of delinquency

Staff

- Lack of targets
- Absence of internal controls
- Ability of management to override controls
- Lack of training
- Unethical work practices:- Fraud/theft
- Lack of effective monitoring of loans

CAUSES OF DELINQUENCY



Internal causes of delinquency

Members

- Lack of education to members/shareholders
- Diversion of loan funds
- Over-loaning
- Multiple loans by members
- Members' deliberate refusal to pay loans
- Project or Business failure

CAUSES OF DELINQUENCY



Internal causes of delinquency

Loan Products

- Poorly researched products (need for change of business model)
- Not responsive to members needs
- Bad loan size, bad timing or poor repayment terms

CAUSES OF DELINQUENCY



Internal causes of delinquency

Management Information system

- The SACCO's MIS should provide key information necessary for portfolio quality management e.g. accurate loan ageing report
- Accurate loan products, applicants eligibility etc
- Facilitate follow up of defaulters with ease
- Should generate timely and accurate reports

CAUSES OF DELINQUENCY



External causes

- Natural disasters
- Government policies
- Economic conditions
- Individual crises

EFFECTS OF DELINQUENCY ON A SACCO



FINANCIAL EFFECTS: CASHFLOW

Lowers cash flow resulting to:

- Loan rationing;
- External credit dependence;
- Reduced ability to provide services that members want and need resulting to loan backlogs

EFFECTS OF DELINQUENCY ON A SACCO



FINANCIAL EFFECTS: PROFITABILITY

Lowers profitability resulting to:

- diminishing ability to cover operational costs including staff wages
- Reduced rebates/Dividends; and
- Slow build-up of institutional capital
- Loan loss expenses directly reduces operating results

EFFECTS OF DELINQUENCY ON A SACCO



FINANCIAL EFFECTS: SUSTAINABLY

- Lowers sustainability by delaying receipt of interest income yet costs remain;
- Slows portfolio turnover thus lowers the productivity of assets
- A slow sure loss of both income and assets hence diminishing shareholder value

EFFECTS OF DELINQUENCY ON A SACCO



BEHAVIOURAL EFFECTS: BAD CULTURE

- Encourages culture of default
- Discourages good borrowers
- SACCO attracts bad borrowers
- Lowers staff morale
- Does not economically empower members
- Lowers image of SACCO
- Costs far more to fight delinquency; prevention is cheaper.

DIRECT COSTS OF DELINQUENCY



- Loan loss provision (provision for bad debts), increases expenses and so reduces surplus
- Interest income from the loan is never received
- The institution loses non-recoverable portion of outstanding loan Loss of capital
- Written off loans result in decapitalization of institution

COST OF DEFAULT ON KSHS. 50M IN DEFAULT WITH KSHS. 10M IN ARREARS.

Description	Loan age	Provision rate	Required Provision
Defaulted Loans	50M	N/A	N/A
1-90 DAYS	20M	1%	0.20M
91-180 DAYS	15M	5%	0.75M
181-270 DAYS	8M	25%	2.00M
271-360 DAYS	4M	50%	2.00M
OVER 360 DAYS	3M	100%	3.00M
TOTAL PROVISION			7.95M

EFFECTS OF HIGH DELINQUENCY



Description	2016 No default	2016 with default	Description
Gross income	100,000,000	100,000,000	Gross income
Less financial expenses	(55,000,000)	(55,000,000)	Less financial expenses
Less operating expenses	(45,000,000)	(45,000,000)	Less operating expenses
Net Income	0	0	Net Income
Loan loss expense	nil	(7,950,000)	Loan loss expense
Net loss after provision	0	(7,950,000)	Net loss after provision
Capital reduction	0	(7,950,000)	Capital reduction

END



THANK

YOU