International Journal of Economics, Business and Finance
Vol. 7, No. 1, April 2020, pp. 1-06, ISSN: 2327-8188 (Online)
Available online at http://ijebf.com

Review article

A Review on Management Systems and Procedures in Handling Loan Delinquencies and Methods of Collection

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Abstract

Loan delinquency is one of the common problems experienced by credit and multipurpose cooperatives. Failures of member-borrowers to pay the regular monthly amortization of the amount granted by cooperatives can also be accounted to its failure to adopt an effective loan collection policy. As such, major factors relevant to this were presented such as collection efficiency, portfolio quality, supervisory and regulatory tool, management tool, natural calamity and force majeur, personal reasons or attitude, problems of collectors for loan payments and policies and lending practices. Therefore, failure of the cooperative to develop a sound collection policy as part of its management systems and procedures would significantly contribute to cooperatives' loan repayment problems.

Keywords: management systems, handling loan delinquencies, methods of collection

INTRODUCTION

Loan delinquency is one of the common problems experienced by credit and multipurpose cooperatives in the country today. Member-borrowers' failure to pay the regular monthly amortization of the amount granted by cooperatives can also be accounted to its failure to adopt an effective loan collection policy. Acosta, et al (2010), pointed out that cooperatives' failure to develop sound collection policy as part of its management systems and procedures significantly contribute to cooperatives' loan repayment problems.

In a similar investigation, Deriada (2011) emphasized that sound collection strategies should be adopted for "non-payroll deduction loan payments" from borrowers to minimize the exceedingly increasing problems on loan payment collection. It was suggested that problems on loan payments can be minimized if cooperatives employ the services of collection officers who collect payments from the creditors on a regular basis. Subsequently, Rivas (2011) suggested that to ensure efficient collection of monthly loan amortization from borrowers, home collection on specified dates agreed between the collectors and creditors should be made to facilitate collection.

However, Magadan (2011) stresses that to ensure collection from member-borrowers, loan payments should be made through payroll deductions for regularly employed borrowers. In addition, the best practice employed by credit and lending institutions to ensure loan payments from borrowers whose salaries are released through ATMs is to require them deposit their payroll ATMs as loan collaterals and collect loan payments directly from the borrowers' payroll ATMs. Though, this practice violates the borrowers' privacy but this is the safest way to ensure loan collection to protect the best interest of the credit and lending institutions.

Collection Efficiency

Collection efficiency helps promote the interest of credit and multipurpose cooperatives because it ensures financial liquidity and enhances credit services to the member-borrowers. In addition, effective and efficient loan collection helps increase institutional capital and provides operational cost including competitive salaries for cooperatives' employees. Collection of loan amortization is more efficient if it is made accessible to the borrowers through ATMs, payroll deductions, and credit cards. In addition, the use of technology such as ATMs for loan payment, test messaging, and electronic mails to remind borrowers of their monthly due should be utilized to ensure collection efficiency (Deriada, et al., 2011). As emphasized by Acosta, et al (2010), cooperatives' loan collection efficiency is measured through on time collection and payments of loans from member-borrowers.

In a similar investigation, Rivas (2011) revealed that penalty for a delayed payment of monthly amortization for delinquent member-borrowers is one of the strategies to minimize delinquency and enhance cooperatives' collection efficiency. However, Magadan (2011) argued that penalty for a delayed payment for delinquent member-borrowers, as a matter of credit policy to enhance collection efficiency, is not helpful because the creditors are more financially burdened and the probability of non-payment of loans would be higher.

Furthermore, Miranda (2004) states that benefits arising from effective collection efforts are many but most important ones maybe presented in summary forms, as follows; reduction in the volume of accounts receivable, freeing capital for carrying the business operation, increasing profits through decrease expenses, shortening of credit period and establishing a line of customers who are financially sound. Miranda (2004) also succinctly explains that the adaptation of an efficient method that will ensure 100% collection of all existing indebtedness will remain an elusive goal, if not an empty dream. For these were possible, then no business firm need suffer from the presence of Bad Debts, which are the nightmare of collection departments and business firms.

Neither would there have been any business or industries which have stopped operations because of them nor did cause say business or industry to fold up in the end. At best, a company can try its best efforts to minimize the incidence and volume of bad debts. On the other hand, collection efficiency of credit cooperatives is one of the key performance indicators in measuring the financial performance. In fact the Cooperative Development Authority, as of December 31, 2010, which has a supervision of the 14,308 multipurpose cooperatives in the Philippines, includes the collection efficiency as one of the criteria for categorization of credit cooperatives because the inability to collect receivables on time will affect its financial position and the Coop-PESOS ratings as indicated the performance standard. The performance standards for credit cooperatives in the Philippines were developed for both purposes. The performance indicators and standards that were identified are those that should be useful to both regulatory and supervisory authorities and the management of the cooperative. Hence, the performance standards for credit cooperatives will be used externally by regulators and internally by management.

Coop-PESOS component is comprised of indicators that look at the financial performance of the credit cooperative. It has the following major categories: ***P***ortfolio Quality; ***E***fficiency; ***S***tability; ***O***perations and ***S***tructure of Assets. The researcher is focusing only on the category of Portfolio Quality.

Portfolio Quality. This first group of ratios/indicators provides the managers and Board of Directors of credit cooperatives appropriate tools in monitoring the quality and the level of risks of the loan portfolio of the cooperatives.

This should be closely monitored inasmuch as the loan portfolio constitutes the bulk of the credit cooperative's assets. In view of this, it is also important that the risk of default is adequately protected. Protection is measured by comparing the adequacy of the allowance provided for loan losses against the amount of delinquent loans. The status of the health of the portfolio of the cooperative will either propel the cooperative to grow or imperil the whole sustainability program of the cooperative. Two indicators are included in this group. These are the Portfolio at Risk (PAR) that measures the risk of default in the portfolio and the Allowance for Probable Losses on Loans measures the adequacy of the allowance for expected losses on loans. Portfolio at Risk (PAR) Ratio reflects the proportion of the loan portfolio with one day missed payment to the total loans outstanding at a given time, and shows the degree of riskiness of the total loan portfolio.

Since loans are usually small and are payable within a short period of time, the likelihood of default of the entire loan balance is high when one amortization payment is missed. The formula for this indicator is: Principal Balance of Loans with at least one day missed payment Total Principal Loan Balance The credit cooperative sector of the Philippines also recognized the need to establish performance standards. The performance standards would enable credit cooperatives and other types of cooperatives with credit services to measure their performance against specific standards and benchmarks. It will also allow individual credit cooperatives to compare their individual performance with the performance of other credit cooperatives objectively. Performance standards for credit cooperatives will be used for the following purposes:

Supervisory and regulatory tool - Since funds for the operations of credit cooperatives are mainly coming from its members, the safety and soundness of the credit cooperative's operation are very important. The members' money in the credit cooperative should be safe considering that the credit cooperative's funds come from members who are mostly small and who belong to the low-income segment of the community.

Management tool - The adoption of the Philippine Performance Standards for Credit Cooperatives will provide management the necessary information on how its cooperative is performing. Management may use these standards in making sure that the cooperative is operating effectively and efficiently. This information would also allow management to determine weak areas and make the necessary adjustments in its policies and/or the way the cooperative's operations are handled. Comparing a credit cooperative's performance against specific standards will allow the management of the cooperative to determine how it fares with other credit cooperatives of similar size. The set of performance standards for Credit Cooperatives in the Philippines were based on internationally accepted standards and best practices adopted by credit cooperatives worldwide. The PESOS indicators will be computed using financial statements generated from the standard chart of accounts for Credit Cooperatives and other types of cooperatives with credit services. The equivalent raw score for both the COOP and PESOS indicators are given the appropriate rating.

The overall rating will be computed using a 20 percent weight for the COOP rating and 80 percent weight for the PESOS rating. The Portfolio Quality, as shown in Table 1, indicator has a maximum raw score of 25% of the total PESOS points that relates the study on the financial performance of a cooperative. The Portfolio at Risk (PAR) measures the risk of default in the portfolio, as shown on the following manner.

Portfolio Quality

Ratios	Standard	Score	Equivalent Points
Portfolio at Risk (PAR)	5% or less	• 5% or less • >5% to 10% • >10% to 15% • >15% to 20% • >20% to 25% • >25%	15 12 9 6 3 0

Natural Calamity and force majeur

Researches under review revealed that the probabilities of failures are higher to loans granted for production of agricultural commodities because agriculture or farming business is subject to natural elements and natural calamities. Rivas (2011) purported that loan delinquencies from member-borrowers of credit and multipurpose cooperatives which granted loan services to small farmers in the countryside were significantly high because agricultural returns were unstable.

Consequently, Magadan (2011) emphasized that cooperative granting credit and loan services to small farmers encountered low financial turn-over due to loan payment delinquencies. Further, the investigation suggests that loan payment delinquencies were attributed to factors like natural calamity such as typhoons, pestilence, drought, and other force majeur or event beyond man's control. In a similar investigation, Chua (2011) reported that the financial interest and institutional capital of credit and multipurpose cooperatives as well as lending institutions granting credit facilities to small farmers in the countryside were protected through agricultural production insurance and seizure of loan collaterals in cases creditors cannot settle their loan obligation after maturity date due to natural calamities. However, it was revealed that there are other malleable management practices of credit cooperatives such as deferral of regular payments for certain period determined by management to victims of floods, typhoons, and other natural calamities.

Personal Reasons or Attitude

Personal reasons and borrowers' attitudes are factors associated to loan delinquency of credit and multipurpose cooperatives. Researches under review exposed that borrowers' attitude towards monthly loan amortization significantly contribute to loan delinquency status of credit cooperatives. As reported by Acosta, et al (2010), loan borrowers who diverted their monthly loan payments for other personal and family needs significantly contribute to loan delinquency problems of credit and multipurpose cooperatives. To enhance collection, Magadan (2011) emphasized that loan borrowers, at the onset, should be made aware on the benefits of prompt payments of loan amortization to maintain good credit and membership standing and help cooperatives improve its capacity to provide loan services to other member-borrowers. Consequently, Rivas (2011) argued that loan delinquencies can be minimized if credit terms and conditions are properly communicated to the borrowers, regular follow up on loan payments by the collector, and constant reminders on due dates are made.

Problems of collectors in following-up Loan payments

Following-up loans from creditors would be easy if statements of accounts are accurately and correctly written and updated in the creditors' ledger and collection notice for overdue accounts are received by the member-borrowers (Magadan, 2011).

However, there were factors that contribute to the problems of collecting officers of credit and multipurpose cooperatives in following-up loan payments from creditors as argued by Acosta, et al (2010) such as death or sickness of either member-borrower or its dependent, termination from the job, bankruptcy or closure of business due to inability of the entrepreneur to manage the business or immediate transfer of borrower's residence without notice to credit cooperatives and/or lending institutions. Consequently, Chua (2011) emphasized that collecting officers of credit cooperatives and lending institutions would have problems on following up loan payments from borrowers specially those who were affected by natural calamities such as typhoons, floods, pestilence, drought, unstable peace and order condition, and other man-made and natural catastrophes. In a similar investigation, Magadan (2011) stresses that creditors who were affected or victims of natural catastrophes would be unable to pay their monthly loan amortization because they lose their properties, businesses and livelihood, members of the family, and worse their sense of balance in their personal and socio-economic activities.

Policies and Practices of Lending

The credit or loan policy regulations of a cooperative explicitly outlines the guidelines that set the terms and conditions for the credit facilities, the member-borrower's qualification criteria, the procedure for making collections, and the steps to be taken in case of loan delinquency. In as much as the application of credit policy affects several areas of the cooperative, all departments must understand the cooperative's credit guidelines and apply them evenly. Credit decisions should be made as quickly as it is consistent with the sound judgment logically based on the existing policies of the cooperative. As espoused by Magadan (2011), sound credit policies and lending practices carved out loan delinquency problems of credit cooperatives and lending institutions. It was emphasized that, as part of the cooperatives' policy, member-borrowers should be subjected to rigid evaluation of their personal capacity to pay through personal interview, collateral, and loan co-maker requirements before the approval of their applied loan amount.

In addition, Chua (2011) emphasizes that credit policy of any credit and multipurpose cooperatives and lending institutions set forth credit terms and conditions which include the borrowers' collateral and co-maker requirements, interest rates, surcharges for delayed payments, collection from co-makers for delinquent borrowers, and loan repayment terms.

Measures to reduce loan delinquency

When the borrowers failed to meet payments of loan on due time, credit or multipurpose cooperatives or lending institutions experience loan delinquency problems. Literature under review revealed that loan delinquency has been one of the concerns of most cooperatives. The failure to recognize this problem and institute the necessary remedies could demoralize both members and officers that would ultimately lead to the failure of the cooperative. The common causes of loan delinquency are irrelevance of loan policies, irresponsible processing system, weak collection system, lack of security on loans, poor example of officers, several loans and lack of cooperative education (Acosta, et al, 2010).

Consequently, Magadan (2011), revealed that the causes of delinquency can be minimized right from the making of the loan policies and even after the loan has been granted. Giving credit counseling to members is one way of improving lending operations. The released loans should be periodically followed up to assure a viable and healthy project that will guarantee full repayment and satisfaction to the cooperative and the borrowers. In a similar investigation, Miranda (2009) reported that loan delinquency would be reduced if cooperatives have adequate socio-economic profiling of the member-borrowers, complete credit investigation and background investigation (CIBI), adequate credit analysis and good judgment based on the 5 C's of credit, adequate loan monitoring and follow-up, proper collection policy, and proper training of cooperatives' or lending employees which include the loan officers and collectors.

As a result, Abasolo (2011) argued that loan delinquency would affect to the credit operations of cooperatives such as no liquidity – lack of available cash; decreasing net profit; slow growth of institutional capital; lessens ability to provide services to members; results in rationing credit; diminishes ability to provide for operational cost including competitive salaries to its staff and employees.

Collection procedures for delinquent member-borrowers

Collection procedures of all credit cooperatives should be strengthened to maintain adequate liquidity position so that they would have sufficient cash on hand to pay obligation and retain as viable operating entities. The generally accepted industry procedures used to achieve proficient administration of the loans receivable. The emphasis is placed on the constant growth and change of proper credit, collection, and financing policies, as well as the assessment and control needed to ensure effective administration of the loans receivable operation. The accounts or loans receivable cycle begins with the organization's decision to extend credit and ends when settlement is received in payment for the products and/or services rendered. It is crucial that cooperative's loans receivable credit, collection, and financing policies complement it is overall marketing and sales objectives. The effective management of the credit function can maximize sales, which directly affect a cooperative's bottom line, while the skillful collection of accounts or loans receivable can lower the cooperative's cost of financing.

According to Stice, et al (2004), improved collection procedures is important because it provides the basis for measurement and accounting for liquidity to all credit cooperatives. Another reason is that cooperatives must maintain an adequate liquidity position so that they would have sufficient amount of cash on hand to pay obligations as they come due and to grant loan to borrowers and if they are to remain viable operating entities. Consequently, Reider, et al (2009) pointed out that cooperative's viability rest on the collection procedures and debt management system for delinquent member-borrowers. They have emphasized that member-borrowers should always be reminded of their loan payments and obligations and be followed up for the settlements of their long overdue monthly loan amortization. In a similar investigation, Abasolo, et al (2009) purported that provision on the reduction of interest rates and reconstructed payments scheme should be made to enhance collection for delinquent member-borrowers. Chua (2011) reported that cooperatives' liquidity is determined on its effective collection strategies. It was emphasized that cooperatives collect from co-makers and/or seize loan collaterals from delinquent member-borrowers.

ACKNOWLEDGEMENTS

The author wishes to thank Dr. Sonnie A. Vedra for the technical help extended and to the constituents of MSU-IIT, whom this paper is dedicated most. To others, who are no longer mentioned but extended support for this study, thank you very much.

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