CHRISTIAN SERVICE UNIVERSITY COLLEGE

SCHOOL OF BUSINESS

DEPARTMENT OF ACCOUNTING AND FINANCE

ASSESSING CREDIT RISK MANAGEMENT PRACTICES IN MICROFINANCE: A CASE STUDY OF FIRST ALLIED SAVINGS AND LOANS

KWAW THERESA

YEBOAH BISMARK

EWUSIE DOREEN ARTHUR

OPOKU AGYEMAN GIDEON

OBENG BOATENG CAROLINE

A THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND FINANCE, CHRISTIAN SERVICE UNIVERSITY COLLEGE SCHOOL OF BUSINESS IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A DEGREE IN BACHELOR OF BUSINESS ADMINISTRATION

MAY, 2015

STATEMENT OF AUTHENTICITY

We have read the university regulations relating to plagiarism and certify that this report is all our own work and do not contain any unacknowledged work from any other source. We also declare that we have been under supervision for this report here in submitted.

Name	**Index No**	**Signature**	**Date**
AGYEMAN GIDEON OPOKU	**10217888**	**……………..**	**…………..**
YEBOAH BISMARK	**10148506**	**…………….**	**…………..**
THERESA KWAW	**10140984**	**……………..**	**…………..**
CAROLINE OBENG BOATENG	**10148461**	**…………….**	**…………..**
EWUSIE DOREEN ARTHUR	**10148368**	**…………….**	**…………..**

Supervisor's Declaration

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision laid down by Christian Service University College.

Supervisor's Name	**Signature**	**Date**
Mr. Fosu Adarkwa	………………………	..…………………..
Solomon Arhin(Dr)	…………………….	………………….
(Head of Department)		

Dean of Business Department's Name

Kwaku Ahenkorah (Dr.)	………………………	………………….

ACKNOWLEDGEMENTS

We are most grateful to the Lord Almighty for his grace and protection that saw as through this study. Our sincere thanks go to our supervisor Mr. Fosu Adarkwa for his constructive advice, comments and corrections. Without him, we could not have completed this research. We are also grateful to all the lecturers of Christian Service University College School of Business for the constructive advice, comments and insightful suggestions. We would like to thank the entire staff of First Allied Savings and Loans Limited for their assistance, guidance and support for this study. Special thanks to our parents, siblings and cousins as well as our course mates for their inspirations and supports.

God bless you all.

DEDICATION

To our mums and dads

ABSTRACT

Credit risk Management has been a priority to all financial institutions that give loans to its customers to increase profitability and reduce risk of loan default in banks operations. This justifies the recent awareness and importance banks now place on managing their loan portfolios. The main objective of this study is to examine how financial institutions manage credit risk in a way to reduce loan defaults considering the diverse customers at hand with different needs and credit worthiness. The main research instruments used were questionnaires, interviews, primary and secondary sources of data.

Results of the study revealed that, the banks dealings with the defaulters of loans falls largely on the shoulders of the loans and relationship officers.

Also, the bank falls short in getting detailed information about their clients past credit records in their dealings with other financial institutions and external relations before granting loans. The research recommends that;

- There is the need to use self help group mechanism where a group of individuals pull their savings into a fund from which they can borrow from when necessary.
- Regular training should be given to the banks’ recovery team to enable them do regular and effective monitoring. Delays in loan approval processes should be curtailed so that borrowers can receive their loans on time and thereby avoid repayment problems.
- Credit risk monitoring and supervision efforts should be intensified by the bank. The bank should ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose.

TABLE OF CONTENTS

CHAPTER THREE METHODOLOGY

CHAPTER FOUR PRESENTATION AND DISCUSSION OF RESULTS

CHAPTER FIVE SUMMARY, CONCLUSION AND RECOMMENDATIONS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF THE STUDY

The last few years have witnessed a significant growth in the microfinance sector in most developing countries, including Ghana. Microfinance form of business encompasses the provision of financial services and the management of small amount of money through a range of products and a system of intermediary functions that are targeted at low income clients. Ledgerwood (1999) observed that microfinance has evolved as an economic development approach through the provision of alternative savings opportunities and cheaper credit to members, notably of credit unions. Ledgerwood's observation is buttressed by Patil (2011) regarding Microfinance Institutions (MFIs) very important role as vehicles of economic development. According to Otero (1999) the main aim of Microfinance is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. That is, it seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. In some regions like Southern Africa, Microfinance is used to describe the supply of financial services to low income employees, which is closer to the retail finance model prevalent in mainstream banking. For some, Microfinance is a movement whose object is "a world in which as many poor and near poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance and fund transfers".

In Ghana, the microfinance sector has evolved from a small informal industry to become a key component of the country's emerging financial sector, providing badly needed financial services to a significant segment of the population, mostly from the rural and informal production sectors. Excluded from formal financial institutions, poor people generally have to rely on loans

From informal moneylenders, who are more likely to exploit the poor by providing loans on enormously high interest rates? To make the world a better place and to enhance international development, the United Nations Organization (UNO) announced in 2000 the millennium development goals, aimed to reduce poverty by half by the year 2015. In this regard, microfinance has recently attracted growing attention and has proven worldwide to be a promising tool to alleviate poverty. Also, Ghanaians reside in rural areas but, more significantly, a sizeable number of the country's working population engage in private informal sector activities. According to the 2000 Population and Housing Census, 80% of the working population is found in the private informal sector. Thus, the role and importance of microfinance as a major source of finance for a significant segment of the country's population.

The provision of microfinance is not only a source of capital funds to the poor who are generally excluded from the financial services sectors of Ghana's formal economy, but also a part of the country's overall national development strategy. Access to financial services is very imperative for the development of the informal sector and also helps to mop up excess liquidity through savings that can be made available as investment capital for national development (World Bank Africa Region 1999).

In other words, microfinance has emerged as an important financing instrument in many African countries (including Ghana), particularly in the quest to reduce poverty and achieve sustainable and equitable growth

The question that remains now is, how are the various Microfinance in the country, dealing with risk with respect to the issuing of credit, since it has been proven that Microfinance can be viewed as a development strategy tool by enabling poor entrepreneurs to initiate their own business, teaching them how to protect the capital they have and to expand their businesses.

1.1 STATEMENT OF THE PROBLEM

The financial sector of every economy is the pivot on which the economy revolves and one crucial player in the sector is the financial institution. Hence, the level of resilience of any economy largely depends on how strong its banking industry is. According to (Kashyap, Rajan and Stein, 1999) banks provide liquidity on demand to depositors through the current account and extend credit as well as liquidity to their borrowers through lines of credit. Due to these fundamental roles, banks have always been concerned with both solvency and liquidity. Traditionally, banks hold capital as a buffer against insolvency, and they hold liquid assets to guard against unexpected withdrawals by depositors (Saidenberg and Straham, 1999). These have made banks actively evaluate and take risks on a daily basis as part of their core business processes.

The microfinance industry on the other hand, has grown rapidly during the last decade. This growth of the industry has changed the risk profile of MFIs. Yet many MFIs seem to continue to seek growth without much attention to credit risk management. Surprisingly, many MFIs appear to neglect even the basic credit risk management which helped banks achieve high growth rates historically.

The study seeks to investigate how microfinance institutions are taking up this high credit risk responsibility, how they manage the high credit risk they are exposed to in other to make profit and stay in business. The credit risk policies they adopt to reduce risk they are exposed to and the impact of the credit risk policies on their clients.

1.2 OBJECTIVES OF THE STUDY

- To assess the existing credit procedures of First Allied Savings and Loans.
- To examine the credit management practices of financial service providers.
- To find out how well First Allied Savings and Loans have been in the management of credit risk.
- To identify the causes of loan defaults and their means of recovery by First Allied Savings and Loans.

1.3 RESEARCH QUESTION

The following research questions guided the study:

i. What are the credit risk management practices in First Allied Savings and Loans?

ii. How does First Allied Savings and Loans manage risks associated with credits?

iii. What inputs go into the drafting of credit policies of First Allied Savings and Loans?

iv. What is the immediate cause of loan default in FASL?

1.4 SCOPE OF THE RESEARCH

This research seeks to study the various policies on credit risk management adopted by First Allied Savings and Loans and the impact of these policies on their clients. The research also looks at how these policies help the organization achieve its goals as a micro finance institution. In the case of attaining the objectives of the study, we will undertake a thorough survey and study the various stakeholders (staff, customers, public regulators etc.) views about the credit issues of the bank. The research focused on First Allied Savings and Loans and other financial institutions in the Kumasi metropolis.

1.5 SIGNIFICANT OF THE STUDY

This research is to expose the managers of MFIs to the various risks factors that are likely to hinder the progress and sustainability of the industry. It is aimed at urging microfinance institutions to be conscious of the various risks and the adverse effects that ignoring them can pose to their institutions. It is to aid managers to appreciate the all-important concept of risk management as an essential aspect of management which needs to be accorded relevance. It seeks to promote the proactive management approach towards risk management as against the remedial or reactive approaches to risk management which offers little chance of recovery from adverse happenings. It also seeks to enlighten the general business public on the issue of credit risk.

1.6 JUSTIFICATION OF THE STUDY

Microfinance institutions play an important role in the nation's development by making loans available to small and medium scale enterprises who do not qualify for loans from the traditional banks, due to their high risk nature. However these institutions are exposed to various types of risk in pursuit of their business objectives, and failures to adequately manage these risks may threaten their survival as business entities. In the case of the researchers, the project is a pre requisite for the partial fulfillment for the award of Bachelor of Business Administration. This research looks at the various risk management policies adopted by micro finance institutions in managing risks encountered during their operations. It also shows the impact of such policies on the beneficiaries of such loans as well as the extent to which these policies help the financial institutions achieve their objectives. The outcome of this research would help advice micro finance institutions on the effectiveness of their risk management policies.

1.7 LIMITATIONS OF THE STUDY

The limitations of the study spells out the constraints that the researcher will face during the study which are time, finance, attitude of respondents and source of information.

- **Time:** The researcher's work was carried out concurrently with the courses offered together with our private works. The project will therefore compete with other academic activities for scarce time.
- **Finance:** The research work is financed by the researchers alone without any financial support from both the school and the organization been researched into.
- **Attitude of respondents:** Some of the respondents felt uncomfortable and reluctant to give and answer some salient questions that can help the research work during interview and the answering of questionnaires that will impede the progress of the research.
- **Sources of information:** Books and materials as basis for the research are sometimes difficult to get and sometimes not sufficient to lay hands on to get the appropriate Information needed for the research.

1.8 ORGANIZATION OF THE CHAPTERS

The beginning chapter of this research sets the tone and direction of the research by introducing the subject matter. It gives information on the background objectives and scope of the study.

Chapter two of this research gives a literature that covers the issue of risk management as used in its broad sense and in business in general. It further gives a synopsis of the evolution of the microfinance industry in Ghana. It then narrows down to the major issue by expounding on the risk management in the context of microfinance. Chapter four of the study deals solely with the Results of the finding and their interpretations. The final chapter is then devoted to the summary of finding; the conclusions and some constructive recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews literature from other researchers on the aspect of credit risk management. It looks at issues such as risk, types of risk, credit risk management practices, the risks associated with credit and many other issues concerning the banking industry of Ghana.

2.1 CURRENT TRENDS IN THE BANKING INDUSTRY OF GHANA

The banking sector has without doubt been one of the business segments that have been visibly impacted by recent economic trends and policy actions. This was revealed, according to a survey conducted by PricewaterhouseCoopers (PWC) with collaboration with Ghana Banking Association. In the year 2013 survey, the growth of the industry was 33% compared to the five year historic (2008-2012) average growth rate of only 26%. The industry, as a whole, also came under attack in the customer deposits market, with the biggest threats posed by government and some nontraditional sources, such as savings and loans companies (S&Ls) and finance houses. The central bank also introduced some new directives on reserve requirements and foreign currency net open positions further constraining banks' ability to lend or acquire interest earning liquid assets. Additionally, an amendment to VAT legislation requiring banks to charge their customers VAT at 17.5% on some of their financial services was announced.

The 2014 Banking Survey revealed that, the supposed lack of education on the new Value Added Tax on certain financial transactions and services issued and directed by the Ghana Revenue Authority (GRA), is feared to negatively impact banking in the country (which took effect from January 2015). A large proportion of the Ghanaian population is already unbanked and the new tax is simply aggravating the situation. Many are opting to keep their monies at home and avoid banking services as much as possible especially many of the newly introduced e-banking services which are becoming key sources of non-interest income for the banks

A unified formula for the computation of the base rates quoted by commercial banks was also introduced in the year under review. Many expected the new formula to bring some sanity in the base rates quoted by commercial banks and perhaps help reduce lending rates given the transparency to be associated with the new formula. The formula lays emphasis on the cost of funds to the banks but many now wonder whether reference should be made to the money market interest rates at which Government borrows, which in reality is a much more major determinant of the base rates of these commercial banks and not the theoretical cost of funds.

The survey also identified many of the commercial banks as now venturing into complex financial products including swaps and derivatives and is supporting many trade related services associated with the new found oil production sector of the economy. The future certainly looks bright and regulation will continue to play a key role in shaping the destiny of the Ghanaian banking sector and help the regulator in enforcing and achieving its monetary policy objectives.

2.2 RISKS IN BANKING

There does not appear to be a single, definitive definition of risk. Traditionally, views on risk usually refer to adverse effects, or a potential for loss. Many people define and perceive it in many ways. Some experts view risk as a form of uncertainty about an outcome of an event in a given set of circumstances. In other words, it is the recognition of the presence of uncertainty, where there may be uncertainty as to the occurrence of an event producing a loss, and uncertainty as regards to the outcome of the event. According to the business dictionary risk can be defined as a probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.

Risk is an integral part of financial services. When financial institutions issue loans, there is a risk of borrower default. When banks collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. Any institution that conducts cash transactions or make investments, risks the loss of those funds. Development finance institutions should neither avoid risk (thus limiting their scope and impact) nor ignore risk (at their folly).

The basic risk faced by banks includes, Operational Risk, Legal Risk and Reputational Risk. Sinkey, (2001) also identified the key portfolio risk of banking as credit risk, interest rate risks, liquidity risk and foreign exchange risk. McNaughton, (1992) stressed that risk taking is central to banking and banks are successful when the risk they take are reasonable, controlled and within their financial reserves and credit competence.

2.3 OPERATIONAL RISK

Although the definitions of market risk and credit risk are relatively clear, the definition of operational risk has evolved rapidly over the past few years. At first, it was commonly defined as every type of unquantifiable risk faced by a bank. However, further analysis has refined the definition considerably. As reported by BCBS (September 2001), Operational Risk can be defined as the risk of monetary losses resulting from inadequate or failed internal processes, people and systems or from external events. Losses from external events, such as disaster that damages a firms physical assets or electrical or telecommunications failures that disrupt business, are relatively easier to define than losses from internal problems, such as employee fraud and product flaws. Marshall (2001) states that operational risk holds the risk resulting from operational failures, within back office or the operational areas of the firm. He also states operational risk from a wider view, is the variance in net earning not explained by financial risks. Marshall, (2001) advocates that operational risk can be defined as residual risk, i.e. everything that is not market or credit risk. Hussain (2000) further specifies that operational risk includes portfolio risk, country risk, and shift in credit rating, reputation risk, taxation risk, business continuity risk and regulatory risk

2.4 LEGAL RISK

Mcormick, R. 2004 defined legal risk as the risk of loss to an institution which is primarily caused by; (a) a defective transaction; or (b) a claim (including a defense to a claim or a counterclaim) being made or some other event occurring which results in a liability for the institution or other losses (for example, as a result of the termination of a contract) or; (c) failing to take appropriate measures to protect assets owned by the institution; or (d) change in law. Whalley, M. 2012, the risk of financial or reputational losses arising from; regulatory or legal action; disputes for or against the company; failure to correct document, enforce or adhere to contractual rights; or failure to meet non-contractual obligations.

2.5 REPUTATIONAL RISK

Reputational Risk is the type of risk related to the trust worthiness of business. According to the Basel Committee on Banking Supervision, reputational risk can be defined as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (eg through the interbank or securitization markets). Furthermore, it exists through the organization and exposure to reputational risk is essentially a function of the adequacy of the bank's internal risk management processes, as well as the manner and efficiency with which management responds to external influences on bank related transactions.

2.6 INTEREST RATE RISK

Interest rate risk is one of the key risks MFIs face today. Interest rates changes on both lending and borrowing rates impact on profits especially in the short term. Increases in cost of funds affect margins adversely, thereby affecting profitability and operational self-sufficiency (GTZ, 2004). With increased competition and pressure to cut interest rates, and the inability of MFIs to pass on interest rate increases to their clients, and proposed regulations on capping margins, interest rate risk will continue to be one of the key threats for MFIs (Bruet, 2004)

.

2.7 LIQUIDITY RISK

Liquidity risk refers to a disparity of maturities of assets and liabilities. Liquidity risk is the possibility of negative effects on the interests of owners, customers and other stakeholders of a financial institution resulting from the inability to meet current cash obligations in a timely and cost-efficient manner. Liquidity risk usually arises from management's inability to adequately anticipate and plan for changes in funding sources and cash needs (GTZ, 2004).

2.8 FOREIGN EXCHANGE RISK

Foreign exchange risk is the potential for loss of earnings or capital resulting from fluctuations in currency values. Microfinance institutions most often experience foreign exchange risk when they borrow or mobilize savings in one currency and lend in another (Bruet, 2004). In Ghana, the appreciation of the dollar actually caused many MFIs that were dependent on dollar denominated loans to begin mobilizing local savings in 1999 to reduce the currency mismatch of assets and liabilities (Asiama & Osei, 2007). Some MFIs use interest rates swaps or futures contracts to "lock-in" desirable exchange rate, to protect them from uncertainties.

2.9 CREDIT RISK

Credit risk is defined as the potential that borrower or counterparty will fail to meet its obligations in accordance with the terms and conditions of the contract. Since most loans advanced by MFIs are unsecured, this exposes them to a great deal of credit risk. Within the literature, credit risk stands out as a key risk faced by microfinance institutions. This is probably due to the fact that lending has been, by far, the mainstay of microfinance business. This is particularly the case of transition or emerging economies such as Ghana, with the dual challenge of lack of credit facilities for small business firms on one hand, and the incident of bad loans and losses suffered by financial institutions on the other hand. Some scholars (e.g. Santomero,1997) have argued that in order to minimize loan losses and so as the credit risk, it is essential for financial institutions having an effective credit risk management (CRM) system in place. Given the asymmetric information that exists between lenders and borrowers, financial institutions must have a mechanism to ensure that they not only evaluate default risk that is unknown to them in order to avoid adverse selection, but also that can evolve in order to avoid moral hazards. However, a broader definition of credit risk also includes the risk of default by other financial institutions, which have payment obligations to MFIs (Bruet, 2004). This is mainly true with MFIs that continue as NGOs. Such payment obligations may come about as a result of MFIs using such institutions as depository institutions, investment outlets, or for money transfers. Also, such risks can arise as a result of the agency cost arising from services that MFIs have provided to other financial institutions. MFIs therefore incur losses when these institutions are unable or unwilling to meet their payment obligations. However, this element of credit risk tends to be overlooked by MFIs as evident in some cases. Credit risks are more important today than in the early stages for those MFIs which have accumulated a significant amount of reserves, part of which in turn is kept in other financial institutions in the form of deposits or investments. Aside from generally recognized default risks by clients, another type of credit risk arises when MFI clients deposit their savings in other financial institutions which are weak and not covered by a credible deposit protection scheme. Clients may not have ready access to their funds and thus loose a source of loan repayment for their MFI loan if the bank where they keep their deposits runs into difficulties (Bruet 2004). In such cases, loan recovery rates may suddenly fall. The assets of most MFI portfolios consist of loans which are relatively illiquid and carry the greatest credit risk. As argued by the theory of asymmetry information, it may be inconceivable to differentiate good borrowers from bad borrowers (Auronen 2003), which is likely to lead to adverse selection and moral hazards problem.

2.10 RISK MANAGEMENT IN MICROFINANCE INSTITUTIONS

Risk management has emerged as one of the key challenges faced by any microfinance institution, whether the institution is an NGO, credit union, finance company or specialized bank. These risks, according to Bruet (2004) vary and require specific strategies to manage. The growth in demand for microfinance services and products in Ghana nowadays raises questions about sustainability of the industry especially with the high rate of default of customers.

MFI investments are medium to long term emerging market investments that bear distinct set of risks for investors. On the one hand, investors face risk that are inherent to the nature of the microfinance sector, while on the other hand various risks emanate from the country risks typical of developing markets. According to Parker (1999), there are two kinds of risks, namely market risk and specific risk (or non-market risk). Market risk by definition is the risk which is common to an entire class of assets or liabilities. Market risk is an investing term referring to the risk an investment security or group of securities will decline in value. This potential for decline in value may come from underlying economic and financial market factors, such as changes in law, changes in interest rates, extreme weather or political environment (Parker, 1999). These risks, according to Bruet (2004) vary and require specific strategies to manage. With regard to country risk, investors need to be aware of the fact that legal institutional and macroeconomic situations in developing countries differ substantially from those in developed countries.

Managing risk is a complex task for any financial organization, and increasingly important in a world where economic events and financial systems are linked. Global financial institutions and banking regulators have emphasized risk management as an essential element of long-term success. Rather than focusing on current or historical financial performance, management and regulators now focus on an organization's ability to identify and manage future risks as the best predictor of long-term success. In order to manage potential risks currently, Ledgerwood (1998) advocates an effective regulatory and policy framework as well as the integration of essential components of institutional capacity building, such as product design, performance measuring and monitoring, and management of microfinance institutions.

As MFIs continue to grow and expand rapidly, serving more customers and attracting more mainstream investment capital and funds will increase. MFIs then need to strengthen their internal capacity to identify and anticipate potential risks to avoid unexpected losses and surprises. A comprehensive approach to risk management reduces the risk of loss, builds credibility in the marketplace, and creates new opportunities for growth. This is due to the fact that effective risk management ensures institutional sustainability and facilitates growth. If risk is not managed well, MFIs will likely fail to meet their social and financial objectives. Donors, investors, lenders, borrowers and savers would tend to loose confidence in the organization and current and potential sources of funding will be lost. It is against this background that this research, seeks to find whether Pathway Microfinance provides the core services of MFI and the eminent challenges they face in providing these services.

2.11 EFFECTIVE RISK MANAGEMENT

Classic risk management requires an organization to take four key steps:

- Identify the risks facing the institution and assess their severity (either frequency or potential negative consequences)
- Measure the risks appropriately and evaluate the acceptable limits for that risk;

- Monitor the risks on a routine basis, ensuring that the right people receive accurate and relevant information; and
- Manage the risks through close oversight and evaluation of performance.

Managing risk is a continual process of systematically assessing, measuring, monitoring, and managing risks in the organization. Effective risk management ensures that the "big picture" is not lost to the urgent demands of day to day management.

Effective risk management encompasses a "feedback loop" from the branch to senior managers, and sometimes to the board of directors, to make sure that policies and strategies are appropriate and that the risk levels are within the risk parameters set by the institution. Creating a risk management infrastructure and system to incorporate that process into the organization's culture helps ensure that all staff are focused on identifying and anticipating potential risks, and not hiding them or denying that they exist. Since risk parameters and tolerances varyover time and among institutions, a systematic internal discipline is needed to reexamine and reassess risks on a regular basis.

Risk management has only recently become a hot topic among financial institutions. Regulation and supervision historically have focused on past performance and current financial condition as predictors of future financial safety and soundness. In the mid-1990's, after several "surprise" bank failures, US regulators shifted the focus of their reviews to place greater emphasis on an institution's internal risk management capabilities in each area of operations, since those are better predictors of the bank's ability to withstand internal or external uncertainties. .

While an increasing number of MFIs are subject to external regulation and supervision, the strength of the MFI's internal control and risk management is far more likely to predict its long-term viability. MFIs have successfully adapted several tools and techniques from the formal financial sector to better manage their institutions, including a “CAMEL” or other analysis, ratio and trend analysis, and peer group analysis. The same adaptations are needed for comprehensive risk management.

2.12 RISK MANAGEMENT FEEDBACK LOOP

The steps in the risk management process are not static; they are part of an interactive and dynamic flow of information from the field to head office to senior management and back to the field. These steps are part of a continual risk management feedback loop that consistently asks whether the assumed risk is reasonable and appropriate, or whether it should be reassessed.

In a nutshell, the risk management feedback loop includes the identification of risks to be controlled, the development and implementation of strategies and policies to control risk, and the evaluation of their effectiveness. If results indicate that risks are not adequately controlled, then policies and strategies are re-designed, re-implemented, re-tested, and re-evaluated

2.13 GUIDELINES FOR IMPLEMENTING RISK MANAGEMENT

These guidelines help a microfinance institution systematize risk management and integrate it into all levels of operations.

- Lead the risk management process from the top
- Incorporate risk management into process and systems design
- Keep it simple and easy to understand
- Involve all levels of staff
- Align risk management goals with the goals of individuals

- Address the most important risks first
- Assign responsibilities and set monitoring schedule
- Design informative management reporting to board
- Develop effective mechanisms to evaluate internal controls
- Manage risk continuously using a risk management feedback loop

2.14 MECHANISM OF THE CREDIT RISK MANAGEMENT IN MICROFINANCE

Microfinance institutions implement multiple mechanisms that overcome the screening and enforcement problems, which reduce the default risk and improve repayment rates. They permit the lender to bypass adverse selection and moral hazard and hence help to maintain high repayment rates. Kono and Takahashi (2010) describe the existing literature and theoretical models on innovative factors underlying the high repayment rates in microcredit programs. They present simple models to argue that different elements of microcredit, such as group lending solve the problems of asymmetric information in the credit market. However, a large part of MFI does not offer group but just individual loans. Armendariz and Morduch (2000) have highlighted several important mechanisms that allow MFI to generate high repayment rates from poor borrowers without requiring collateral and without using group lending contracts. These mechanisms include the use of non-refinancing threats, regular repayment schedules, collateral substitutes, and the provision of nonfinancial services

2.15 INCENTIVE MECHANISM OF GROUP LENDING

One of the major mechanisms that most MFIs employ is group lending. Group lending refers specifically to arrangements by individuals without collateral who get together and form groups with the aim of obtaining loans from a lender. According to Kono and Takahashi (2010), in the typical group lending scheme:

a) Each member is jointly liable for each other's loan.
b) If any member do not repay, all the members are punished (often in the form of denial of future credit access), and
c) Prospective borrowers are required to form groups by themselves

Many economic works on microfinance focus on the incentives induced by joint liability in group lending contracts and nearly all authors have proven that group lending enforces joint liability mechanisms, involves borrowers in sharing information and then reduces asymmetric information (Besley and Coate, 1995; Ghatak, 1999; Kono and Takahashi, 2010; Stiglitz, 1990; Van Tassel, 1999). Zeller (1998) uses information on 168 credit groups in Madagascar and shows that the group effectively generates insurance, transfer screening and monitoring costs from the bank to borrowers, providing an effective way for MFIs to overcome adverse selection, moral hazard, and enforcement problems, which leads to a better repayment performance.

In summary, group-lending mechanism can potentially deal with information asymmetry,

Therefore reduces risk-taking and improves the lender’s repayment rate. Armendariz and Morduch (2005) argue that the secret to the high repayment rates on loans is tied closely to the use of the group lending contracts. Besides the benefits of group lending in reducing information asymmetry, group lending can be an effective and efficient way to reduce the high transaction costs in both searching reliable borrowers and ensuring the repayment of credit .

However, group lending in practice suffer from some disadvantages such as domino effect or risk of contagion if one of the members is unable to meet repayments (Armendáriz and Morduch, 2000; Churchill, 1999).

2.15.1 Dynamic Incentives

Lenders may use dynamics incentive as an important incentive mechanism (Besley, 1995; Kono and Takahashi, 2010; Morduch, 1999). Although group lending mechanism manages credit risk only in group loans, the mechanism of dynamics incentive or progressive lending, as named by Armendariz and Morduch (2005), can manage credit risk both in group and individual loans.

Dynamics incentives mechanism boils down to the threat not to refinance a borrower who defaults on her debt obligations. This incentive has a large effect on microfinance borrowers' behavior because they have considerable needs for future loans to develop their business. Morduch (1999) notes that the repeated nature of the interactions and the credible threat to cut off any future lending when loans are not repaid can be exploited to overcome information problems.

Indeed, this mechanism allows lenders to build a long-term relationship with borrowers over time, to generate reputation mechanisms and screen out the worst prospects before expanding loan scale

2.15.2 Collateral Substitutes

Collateral substitutes serve as a means to secure repayment. MFIs especially during their initial years of operation require borrowers to pay 0.5 percent of every unit borrowed (beyond a given scale) in order to collect the emergency fund. The emergency fund serves as insurance against loan default, death or disability (Morduch, 1999).In addition, MFI providing individual microcredit may require guarantor agreeing to guarantee the borrower's loan. However, it must be noted that the essential role of a guarantor is to be a decisive factors for granting the credit and not a secondary repayment source.

2.15.3 Repayment Schedule

Even though economic theory suggests that a more flexible repayment schedule would benefit clients and potentially increase their repayment capacity, microfinance practitioners believe that the discipline imposed by regular repayment maintains high repayment rates in the absence of collateral. Although that this feature is less usual than the previous mechanisms, it helps MFI to maintain high repayment rates (Armendariz and Morduch, 2000; Morduch, 1999). In the MFI, the repayment starts almost immediately after disbursement and then occurs on a weekly or monthly basis. Morduch (1999) points out the different advantages of regular repayment schedules. He argues that it:

- Screens out undisciplined borrowers at an early stage
- Gives early warning to loan officers and peer group members about potential future problems.
- Permits the banks to get hold of cash flows before they are consumed or otherwise diverted
- Requires that the borrowers have an additional income source on which to rely since the repayment process begins before investments bear fruit. This permits a positive selection of clients for the lender and for diversified households (Armendariz and Morduch (2000)).

Field and Pande (2008) note that regular payment schedule provide clients a credible Commitment device, which enables them to form the habit of saving regularly. They note also that frequent meetings with a loan officer may improve client trust in loan officers and their willingness to stay on track with repayments.

2.16 GENERAL PRINCIPLES OF LENDING

In this segment, the ground rules for the credit assessment of individual proposition will be considered. ‘Rules’ is perhaps not the right word because Robbins and Stobaugh (2000) indicate that experienced lenders use a mixture of technical knowledge and common sense rather than rules. Each lending case has to be treated on its merit, but Essiem (2005), explains that there is a number of general principles, which should be applied in all cases.

A Philosophy for Lending

According to Dyer (2004), a lender does lend money and does not give away. There is a judgment therefore that at some future date repayment will take place. The lender needs to look into the future and ask: will the customer repay by the agreed date?. There will always be some risk that the customer will be unable to repay, and it is in the assessing this risk that the lender needs to demonstrate both skill and judgment. The lender’s objective will be to assess the extent of the risk and try to reduce the amount of uncertainty that will exist over the prospect of repayment. While there are guidelines to follow, there is no ‘magic formula’. The lender must gather together all relevant information and then apply his or her skills to making a judgment.

The Professional Approach

It is the conviction of Rouse (2005) that lenders must seek to arrive at an objectives decision. This is not as easy as it sounds as there will always be pressures from customers and elsewhere, for example the need to meet profit targets that may sway the lenders judgment. A customer may press for a quick answer when the lender does not feel there is adequate information. The approach of the true professional is to resist outside pressures and to insist on sufficient time and information to understand and evaluate the proposition. It is a lender who is taking the risk and it is not professional to teach the wrong decision

The professional lender who is confident in his or her ability, according to Jorion (1997) will always apply the following principles includes;

- State time to reach decision – Detailed financial information takes time to absorb. If possible, it is preferable to get the 'paper work' before the interview, so that it can be assessed and any queries identified.
- Do not be too proud to ask for a second opinion – Some of the smallest lending decision can be the hardest. Get full information from the customer and not make unnecessary assumptions or fill in missing detail.
- Do not take a customer's statements at face value and ask for evidence that will provide independent corroboration.
- Distinguish between facts, estimates and opinion when forming a judgment.
- Think again when the 'gut reaction' suggests caution, even though the factual assessment looks satisfactory.

Methodical Approach to Appraisal

In the views of Havrilesky and Boorman (2001), there are five stages to any analysis of new lending propositions namely, introduction of the customer, the application by the customer, review of the application, evaluation, monitoring and control.

Introduction of the Customer

Lenders do not have to do business with people they do not feel comfortable with. The account opening procedures should be such as to establish, as far as possible, that the customer is honest and trustworthy. This is especially important when the customer wishes to borrow at a later stage. Approaches for borrowing from customers of other banks, in the of Hester and Pierce (2002) merit special caution; why is the approach being made at all? Has the proposal already been rejected by the other bank? If the potential customer ought to have financial fact record, but does not appear to have one, a degree of suspicion is in order.

An important source of new business for most lenders according to Hodgman (2001) is introductions form professional advisors such as accountants and solicitors. This is not to say that a bank is obliged to lend to customers introduced in this way. Indeed, there is no evidence to suggest that such customers are generally of better quality than others. The bank should treat such case on merits and subject each proposition to an objective assessment. Some introducers try to put pressure on the lender. The lender, in the view of Fallon (1996), must not succumb to such pressure and needs to avoid relying too heavily on any individual source of new business. A good introducer will respect a lender who shows objectivity, while caving in under pressure will only result in being considered a 'soft touch' and generate the introduction of other less attractive prospects.

The Application

This according to Phelan (1992) can take many forms but should include a plan for repayment by the borrowing and an assessment of the contingencies that might reasonably arise and how the borrower would intend to deal with them. It might be in detailed written form or merely verbal.

There are many instances when the lender will have to draw out sufficient further information to enable the risk in the proposition to be fully assessed.

Review of the Application

Dyer (2002) recommends that all the relevant information that is required need to be tested and other data sought if necessary. Either formally or informally, the lender applies what are generally known as the canon of good lending. The main areas common to all lending propositions are examined in some detail. It is sometimes difficult to remember all the points to be covered during an interview and many lenders use a mnemonic as a check list. There are a number of mnemonics in common use, but the most prevalent are probably CCCPARTS (Character, Capital, Capacity, Purpose, Amount, Repayment, Terms and Security), PARSER (Persons, Amount, Repayment, Security, Expediency, Remuneration) and CAMPARI which is used by major clearing banks, it is probably the most popular of the mnemonics and is the one described in detail here. It stands for: Character, Ability, Margin, Purpose, Amount, Repayment, and Insurance (Security).

Character

Saunders (1996), explains that although some might claim otherwise, it is virtually impossible to assess an individual's character after just one meeting. It is an extremely difficult area but a vital one to get right. Facts, not opinion, are crucial, e.g. how reliable is the customer's word as regards the details for the proposition and the promise or repayment? Does the customer make exaggerated claims that are far too optimistic or is a more modest and reasonable approach adopted; is the customer's tract record good? Was there any previous borrowing, and if so, was it repaid without trouble. If the customer is new, why are we being approached? Can bank statements be seen to assess the conduct of the account?

Ability

This aspect relates to the borrowers' ability in managing financial affairs and is similar to character as far as personal customers are concerned. Further points in respect of business customers, according to Marshal and Siegel (1996) would include: Is there a good spread of skill and experience among the management team , for example, production, marketing and finance, Does the management team hold relevant professional qualifications? Are they committed to making the company successful? Where the finance is earmarked for a specific area of activity, do they have the necessary experience in that area?

Margin

Agreement should be reached at the outset with the borrower in respect of interest margin, commissions and other relevant fees. The interest margin, according to Allen and Santomero (1997), will be a reflection of the risk involved in the lending, while commission and other fees will be determined by the amount and complexity of the work involved. It should never be forgotten that banks are in business to make profits and to give shareholders a fair return on their capital.

Purpose

The lender will want to verify that the purpose is acceptable. Perhaps the facility would not be in the customer's best interest. According to Edward and Millet (2002), customers do tend to overlook problems in their optimism and, if the bank can bring a degree of realism to the proposition at the outset, it may be more beneficial to the customer than agreeing to the requested advance.

Amount

Dyer (2004), notes that this is important to verify whether the customer is asking for either too much or too little. There are dangers in both and it is important, therefore, to establish that the amount requested is correct and that all incidental expenses have been considered. The good borrower will have allowed for contingencies. The amount requested should be in proportion to the customer's own resources and contribution. A reasonable contribution from the borrower shows commitment and a buffer is provided by the customer's stake should problems arise.

Repayment

The real risk in lending, in the view of Rouse (2005) is to be found in the assessment of the repayment proposals. It is important that the source of repayment is made clear from the outset and the lender must establish the degree of certainty that the promised funds will be received. Where the source of repayment is income/cash-flow, the lender will need projections to ensure that there are surplus fund to cover repayment after meeting other commitments.

Insurance/Security

Ideally, the canons of lending in the view of Berger and Udell (1995) should be satisfied irrespective of available security, but security is often considered necessary in case the repayment proposals fail to materialize. It is vital that the provider of security, especially third party security, understands fully the consequences of charging it to the bank. It is equally important that no advance is made until security procedures have been completed, or are at least at a stage where completion can take place without the need to involve the borrower any further.

The Indian Microfinance Experience

Home to the largest population of poor in the world, India has been a natural candidate for experimenting with microfinance as a tool for poverty alleviation. With a nationalized formal banking sector that has emphasized rural and developmental banking for several decades now, India's involvement with small credit targeted primarily at the rural poor is hardly new. However, recent years have generated unprecedented interest in microcredit and microfinance in the form of group-lending without collateral; thanks in part to the remarkable success of institutions like the Grameen Bank in neighboring Bangladesh , Bancosol and others in more distant lands.

The performance of organizations like SEWA in Western India and SHARE and BASIX in Southern India have convinced many a sceptic that microfinance can indeed make a difference in India as well. Microfinance provides an important way to balance the outreach among the rural poor while keeping the cost of lending low, to the extent that the costs of credit risk assessment and monitoring can be reduced with the help of NGOs, banks can actually reach out to a large number of truly poor households without incurring heavy transactional expenses.

Self Help Groups (SHGs) form the basic constituent unit of the microfinance risk management practices in India. An SHG is a group of a few individuals, usually poor and often women, who pool their savings into a fund from which they can borrow as and when necessary. Such a group is linked with a bank, a rural co-operative or commercial bank where they maintain a group account. Over time the bank begins to lend to the group as a unit, without collateral, relying on self-monitoring and peer pressure within the group for the repayment of these loans.

However, evidence largely points to the several beneficial side effects of microcredit. In particular, empowerment of women and the inculcation of financial training and discipline amongst the poor will undoubtedly have long-term socio economic benefits. The principles of self-help and microcredit have also helped microfinance institutions achieve significant growth and profitability in recent years.

CHAPTER THREE

METHODOLOGY AND ORGANIZATION PROFILE

3.0 INTRODUCTION

This chapter is based on the research design and methodology procedures employed to complete the study which includes the methods used by the researcher for data collection, sampling and the analysis of the data collected. The study is designed to investigate Credit risk Management Practices of First Allied Savings and Loans.

3.1 RESEARCH FRAMEWORK

The research enables some aspect of the problem to be studied in detail within a time frame which was used for the research and collection of data for the research. The research was by the use of questionnaires and interviews. Face-to-face interviews were conducted with the bank personnel of First Allied Savings and Loans and other related financial institutions. Questionnaires were also administered to the bank personnel's and some customers of the various financial institutions.

3.2 SOURCES OF DATA

3.2.1 Primary Data

The primary source of data refers to statistical data which the investigator acquires for the purpose of the study through the use of questionnaires and personal interviews. The primary source of data provides first hand data which can be validated. Questionnaires were administered to gather the primary data from employees of the bank whiles interviews were conducted to gather information from senior credit officers of the various banks.

The employment of this method of data collection enlightened the researcher's awareness of credit risk management as he had first-hand information about the activities of the bank.

3.2.2 Secondary Data

The secondary source of data refers to subsequent publication of primary data which are more available in the public domain. These may include journals, books, published businesses and the news media. Among such methods utilized which has a bearing on the topic included reports and other documents on the operations of First Allied Savings and Loans as well as from journals was of immense benefit to the study.

3.3 SAMPLE POPULATION AND SIZE

First Allied Savings and Loans, Adum branch and other two branches in Kumasi, together with Multi Credit and Abi National Savings and Loans were used as the population sample for this research. The research topic of this study is to find out how credit risk is Managed in financial institutions and we narrowed ourselves to how First Allied Savings and Loans, Adum branch manages its credit. Based on this the researchers used the staff members of the credit department of the Adum Branch and heads of the credit department and other different financial institution as the population sampling. A total of eighty (80) questionnaires were administered to the various financial institutions and fifty (50) were received.

3.3.1 Sampling Techniques

A simple random sampling technique which refers to, selecting each individual randomly and entirely by chance such that each individual has the same probability of been chosen at any stage during the sampling process was used for the study. For the purpose of this research the relationship officers were contacted since they were responsible for the information required. Purposive sampling technique was also used to derive information from the customers.

Purposive sampling is a non-representative subset of some larger population, and is conducted to serve a very specific need or purpose" (Trochim 2005). This method of sampling was useful to the research because it consumes less time and is much less expensive. Another reason for the usage of purposive sampling was that the employees not qualified for the requirements are eliminated since the results are expected to be more accurate.

3.4 METHODS OF DATA COLLECTION

3.4.1 Questionnaires

Questionnaire was the major tool used for the collection of the data. It consists of series of questions drafted for the respondent to answer in the form of "yes" or "no" and to comment or make suggestions where necessary.

All the different sets of questionnaires have sub-questions as follow-ups to major questions. The heavy reliance on questionnaires was based on this appeal in allowing respondent to provide answers at their own convenience.

3.4.2 Interviews

The researcher used the face to face type of interview and personal conversation in conducting the research. This was carried between the researchers and the relationship Officers of the various financial institutions. Some customers were also interviewed on the credit practices of the bank.

3.5 METHODS OF DATA ANALYSIS

The data collected were edited and collated, which is rearranging the faulty results and correcting them to suit the purpose for the research .The data is then put together for analysis.

After analyzing the data collected, the types of data analysis procedures, qualitative and quantitative analysis were used to analyze the data collected.

Due to the nature of our data collected SPSS and other computer statistical tools were used. The results of the data analysis were presented in the form of graph and charts.

3.6 PRODUCTS AND SERVICES OF FIRST ALLIED SAVINGS AND LOANS

Savings Account

Our Savings Account is available to customers who desire to make regular deposits and build on them to meet their future needs, to do so profitably. Very low initial deposit of GH¢5 is required.

Benefits:

- Unlimited number of Cash withdrawals.
- Quarterly payment of high interest on savings account.
- Easy access to loans
- Statement of Account upon request.

Fixed Deposit

Fixed Deposit is an investment account that is offered for a fixed term or on rollover basis. The very high interest rates associated with this product may be negotiated or fixed at the time of investment. Fixed deposits may be placed for terms of one month, three months, six months or one year.

Benefits:

- High and competitive interest rates are offered on maturity.
- Instant access to your money.
- Fixed Deposits can be used as collateral for a loan.

Golden Susu

- This is passbook daily saving programmed designed to assist micro/small-scale entrepreneurs to expand their businesses.
- Contributors may, after two months savings, be eligible for loans.
- Repayment of the loan is made through a flexible repayment package covering a period of between six and twelve months.

Super Golden Susu

- This is a specially designed savings and loans product for customer who go through two loan cycles of the Golden Susu program and can contribute a daily minimum saving of one hundred Ghana cedis.
- Customers can access loans ranging between ten thousand Ghana cedis and forty thousand Ghana cedis with flexible repayment terms.

Allied Mpuntu Scheme / Micro Finance (Group Loan Scheme)

- This is a band group saving and Loans programmed designed to the meet the banking needs of customers.
- Individual members of the group are required to make a minimum daily savings for eight weeks.
- Customers are granted flexible terms to pay off loans granted under this scheme.

Premium Golden Susu

- This is an individual loans program designed for Allied Mputu group members who require large amounts of money to expand their businesses.
- The loan amounts for the program are very attractive.
- Customers are granted flexible repayment terms to pay off their loans.

Fast Track Susu

- This facility which offers enhanced loan facility grant access to loans after only 20 days susu contribution.

Susu Overdraft

- The facility enables customers to overdraw their susu accounts whenever they are in need of funds. The speed with which customer can access this facility is remarkable.
- This offer enhanced loan amounts to customer who require huge sums of money to improve their businesses.
- We offer carefully designed loan products to meet specific needs of our customers. These include:

CHAPTER FOUR

PRESENTATION AND DISCUSSION OF RESULTS

4.0 INTRODUCTION

This chapter presents the findings of the study based on the methodology espoused in chapter three. This is followed by the discussion of the results. The findings from the Study are discussed under these sections. In this section, the study conducts an evaluation of the credit risk management practices in First Allied Savings and Loans Ltd.

4.1 FINDINGS

From the data collected and analyzed, these are the findings the researcher came out with.

Table 4.1 Accessing the Existing Credit Procedures

	N	Minimum	Maximum	Mean	Std. Deviation
CUSTOMERS CREDIT WORTHINESS	50	1.00	4.00	1.3800	.72534
PAYMENT TERMS	50	1.00	4.00	2.0600	.79308
APPROVAL PROCEDURES	50	1.00	4.00	2.8200	.52255
PROCEDURES TO COLLECT OUT STANDINGS	50	1.00	4.00	3.7200	.72955
Valid N (list wise)	50				

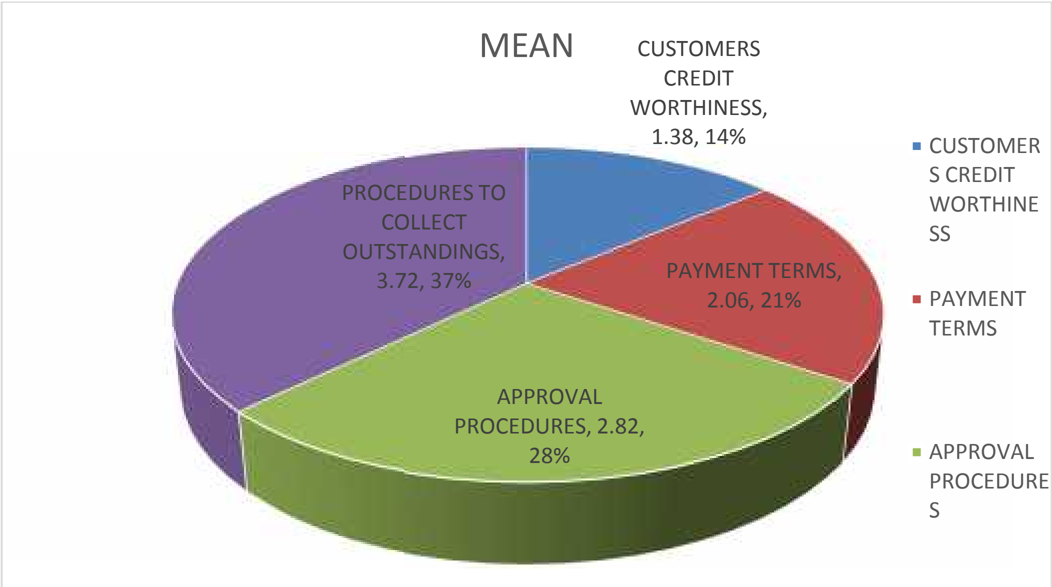

Figure: 4.1

According to the responses derived from the research the following were the existing procedures used by the organization; customer credit worthiness, payment terms, approval procedures, procedures to collect out standings. However, figure 4.6 above shows that 37% of the respondent said procedures to collect outstanding is the most considered procedure in the granting credit and 14% of the respondent said customer credit worthiness is the least procedure considered in the granting of credit. This shows that procedures to collect outstanding is of great significance when it comes to granting of credits to clients.

Table 4.2 How Well The Organization Has Been In The Management Of Credit Risk

	N	Minimum	Maximum	Mean	Std. Deviation
Credit risk management policy	50	1.00	2.00	1.0800	.27405
Management of credit risk for the past years.	50	1.00	3.00	1.3600	.52528
Loan default rate	50	1.00	3.00	1.1800	.43753
Staff knowledge on credit risk management.	50	1.00	3.00	1.4200	.64175
Verification of client information.	50	1.00	2.00	1.1000	.30305
Valid N (list wise)	50				

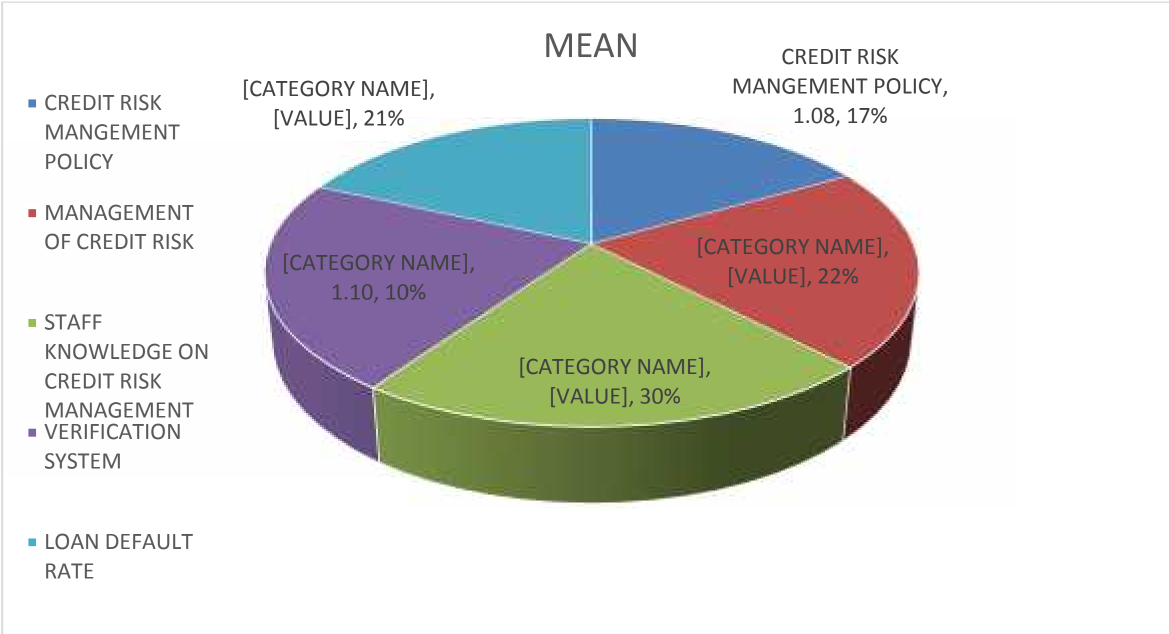

Figure: 4.2

From the above table.4.2 the respondent rate Staff knowledge as the highest with a mean of 1.42 which signifies that the organization is performing well in the management of credit risk. Verification of client information had the least respondent with a mean of 1.10.

Table 4.3 Identifying The Causes Of Loan Default And Recovery Means

Causes of Loan Default	N	frequency	percent	Valid percent	Cumulative percent
Harsh Economy	50	33	66.0	66.0	66.0
Diversion of funds	50	9	18.0	18.0	84.0
Ignorance	50	8	16.0	16.0	100
Means of Recovery					
Debit guarantors	50	11	22.0	22.0	22.0
Court	50	6	12.0	12.0	34.0
Collateral security	50	32	64.0	64.0	98.0
Error		1	2.0	2.0	100

Causes of Loan Default

As a financial institution which deals in the granting of credit to its customers, there are various causes of credit default faced by the institution. The respondent were asked to choose among various causes of credit default and Harsh economy had the highest frequency with a percentage of 66 and Ignorance had the lowest frequency with 16%.

Means of Recovery

It is very important for financial institutions to engage in debt recovery in order to attain loans credited to customers. Respondents were asked to state the various means by which debts are recovered. From the survey conducted, 64% said collateral security is the best method of debt recovery.

Table 4.4 Credit Management Practices

	N	Minimum	Maximum	Mean	Std. Deviation
Credit granting policy	50	1.00	2.00	1.1400	.35051
Internal control	50	1.00	3.00	1.6600	.59281
Staff training	50	1.00	3.00	1.3800	.53031
Credit scoring models	50	1.00	12.00	1.7800	1.56870
Debt collection	50	1.00	2.00	1.3400	.47852
Client project evaluation	50	1.00	3.00	1.4600	.54248
Valid N (list wise)	50				

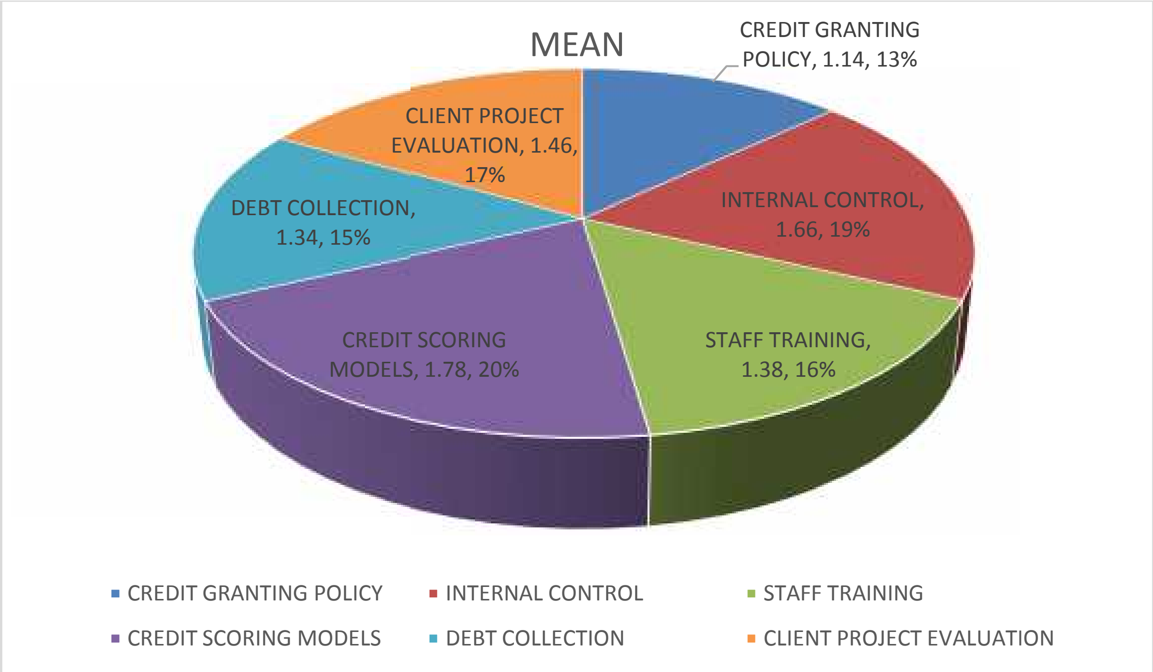

Figure 4.3

The effectiveness of Credit Risk Management Practices is very essential to financial institutions. This enables the financial institutions to know whether they are achieving good financial performances in relation to Credit Risk Management. The respondents were asked to rate the importance of Credit Risk Management Practices. Credit scoring model had the highest mean of 1.78 which signifies that it is an important credit risk management practice in the organization. Credit granting policy had the least mean of 1.14

Table 4.5 Credit Risk Management Practices In Granting Credit To Client

	N	Minimum	Maximum	Mean	Std. Deviation
Appraisal of customers	50	1.00	4.00	1.1400	.53490
Disbursement	50	1.00	4.00	2.0800	.52838
Monitoring	50	1.00	4.00	2.8200	.56025
Recovery	50	2.00	4.00	3.8600	.40457
Valid N (list wise)	50				

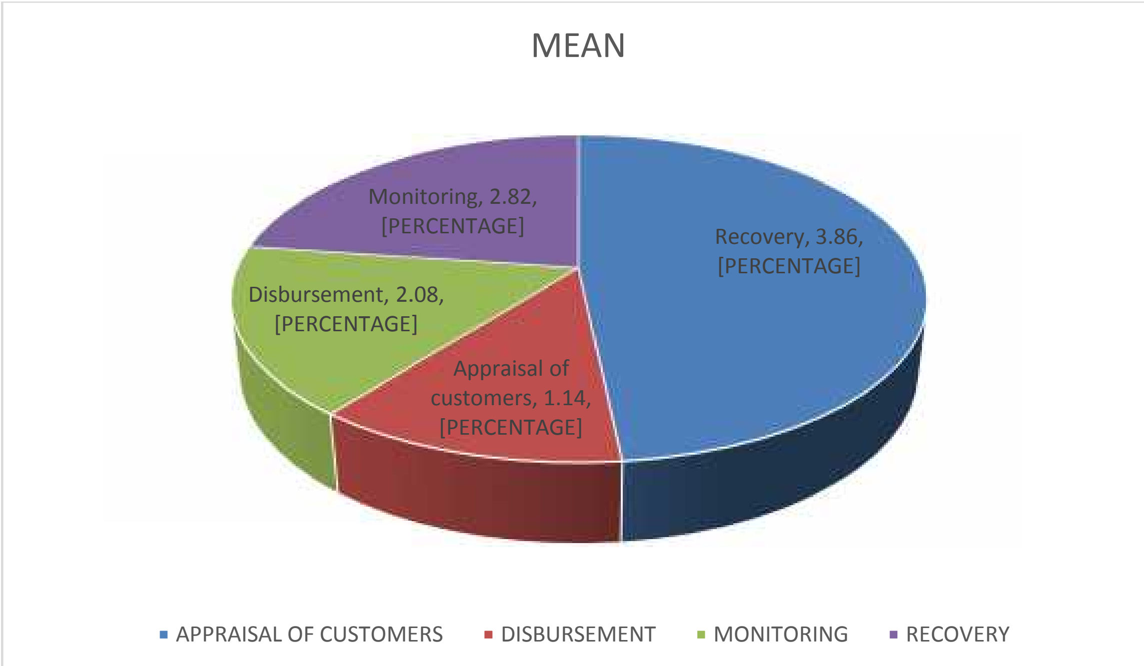

Figure 4.4

Credit Risk Management practices in granting credit to clients is also essential to financial institutions. The respondents were asked to rate the most important procedure in granting of credit to clients in credit risk management practices. Recovery had the highest mean of 3.86 which signifies that it as an important credit risk management practice in the granting of credit to clients. Appraisal of customers had the least mean of 1.14.

Table 4.6 What Major Risk Does The Organization Face When Given Out Loans.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Default risk	44	88.0	88.0	88.0
	Liability risk	4	8.0	8.0	96.0
	Interest rate risk	2	4.0	4.0	100.0
	Total	50	100.0	100.0	

As shown in table 4.6 above, 88% of the respondent chose default risk as the major risk faced when giving out loans and 4% selected interest rate as the least risk the organization face when giving out loans.

Table 4.7 How Is Risk Being Managed

	N	Minimum	Maximum	Mean	Std. Deviation
Active Loan Monitoring	50	1.00	3.00	1.2200	.50669
Evaluation of Loan Project	50	1.00	3.00	1.7000	.50508
Education of Borrowers	50	1.00	3.00	1.6800	.58693
Valid N (listwise)	50				

In table 4.7 Evaluation of Loan Project constitute the highest mean of 1.70 and Active Loan Monitoring had the lowest mean of 1.22. This shows that Evaluation of Loan Project is the major means of managing the default risk faced when giving out loans.

Table 4.8 Official Status in The Organization

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Credit Officer	40	80.0	80.0	80.0
	Teller	6	12.0	12.0	92.0
	Management	4	8.0	8.0	100.0
	Total	50	100.0	100.0	

From table 80% of the respondent were Credit Officers of the organization and 8% of the respondent were Management members. This signifies that most of the questionnaires were answered by Credit Officers of the organization.

Table 4.9 Responses by Customers

QUESTIONS	**YES**	**NO**
Are you a client of First Allied Savings and Loans?	30	0
Do you always meet the requirements for loans?	20	10
Does the bank require collateral security before granting loans?	28	2
Are interest rate charged on loans favorable?	13	17
Are you able to repay your loan on time?	22	8
Do you see any flexibility in the payment of loans?	18	12

From table 4.9 above, all 30 respondents confirmed that they are customers of First Allied Savings and Loans. 20 respondents also agreed to meet all loans requirements from the bank. 17 of the bank customers showed that there are high interest rate charged on loans whiles 13 of the respondent indicate that they are favorable. Also 18 respondents showed that they are able to repay their loans on time and 12 of them showed that they are unable to repay their loans on time

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

The researcher assessed the credit risk management practice of First Allied Savings and Loans and compared them to what is the best practice in the industry. The Overall outcome showed an acceptable compliance with the requirements of the industry. At First sight, their practices were good, although we found some discrepancies and noted some weaknesses that if well managed can improve the existing credit management practice.

5.1 SUMMARY OF FINDINGS

- The findings of the study illustrates that financial institutions manage credit risk management in the following ways: active loan monitoring, evaluation of loan project, procedures to collect outstandings, staff training, adequacy of collateral security, monitoring and controlling are considered to be the methods that enhances the reduction of credit risk.
- Further, First Allied Savings and Loans falls short in getting detailed information about the credit worthiness of their clients in their dealings with other financial institutions and external relations before granting loans. It is, however, an undeniable fact that because the institution would want to expand their client base and minimize cost, they give loans to them after being satisfied with their laid down requirement.

- Weak chemistry within the work force of the institution in dealing with credit risk management. It was found out that, with the institution dealings with the defaulters of loans always fall on the shoulders of the credit department where other department do not adequately contribute much to provide any other information about the defaulter. Due to their various tasks, other departments do not see the situation as their responsibility forgetting that achievement of objective is dependent on one another.

5.2 CONCLUSION

In conclusion, it has been accepted that credit risk cannot be completely eliminated but can be managed to reduce it to a considerable length. Banks should therefore screen borrowers thoroughly to authenticate their credit worthiness using the five Cs namely (character, capacity, capital, collateral and conditions). Before credits are advanced to them since majority of the causes of loan defaults are from borrowers.

Banks advance credit with the hope that borrowers will pay back with interest. Even though this is the ideal situation, it does not sometimes happen as borrowers are not able to pay back their loans and overdrafts. This situation is what is known as credit risk.

Banks should therefore do all within their power to reduce the probability of credit defaults to the barest minimum so that they do not have to keep colossal amounts as provision for bad and doubtful debts which is an expense item that will eventually reduce the profitability of the bank.

5.3 RECOMMENDATIONS

As with every research, this research is meant to find some solutions to the problem of loan default and to minimize credit risk which is becoming a bane of the bank. From data gathered from the research above.

- There is the need to use self help group mechanism where a group of individuals pull their savings into a fund from which they can borrow from when necessary.
- Borrowers should also avoid multiple borrowing from different institutions as it leaves them with a high gearing and generate repayments problems
- Credit risk monitoring and supervision efforts should be intensified by the bank. The bank should ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose.
- Regular training should be given to the banks' recovery team to enable them do regular

  and effective monitoring. Delays in loan approval processes should be curtailed so that borrowers can receive their loans on time and thereby avoid repayment problems.
- The bank should put in place proper structures to make sure that clients credit worthiness with other banks can be effectively retrieved.

REFERENCE

Adjei, J.K. (2010). Microfinance and Poverty Reduction: The Experience of Ghana, Accra: BOLD Communications Limited.

Buehler, K. and Pritsch, G. (2003), Running with risk,The McKinsey Quarterly, number 4, 2003 Edelberg, W., (2004), testing for Adverse Selection and Moral hazard in Consumer Loan Markets, Working Paper, February 2004.

Fatemi, A. and Glaum, M. (2000), “Risk management practices in German firms”. Journal of Management Finance, Vol. 26, no.3, pp 1-17.

Finance Conference, Goethe University, Frankfurt, September 1999.

Ledgerwood, J. (1999). Microfinance handbook: an institutional and financial perspective: World Bank Publications.

Otero, M. (1999).” Bringing Development Back into Microfinance” A paper presented at the New Development .

Spence, A.M., (1976), competition in salaries, credentials, and signalling prerequisites for jobs,Quarterly Journal of Economics, 90, pp. 51-74. Stiglitz, J.E., (1984), Equilibrium unemployment as a worker discipline device,American Economic Review, 74, pp. 433-444.

Tobin, J. (1963), ‘An Essay on the Principles of Debt Management’, in J. Tobin (ed.), Fiscal and Debt Management Policies, Englewood Cliffs, NJ, PrenticeHall.

www.ghanaweb.com/ PriceWaterHouseCoopers launches Ghana Banking Survey 2014.

APPENDIX I

CHRISTIAN SERVICE UNIVERSITY COLLEGE QUESTIONNAIRE FOR THE CREDIT DEPARTMENT OF FIRST ALLIED SAVINGS AND LOAN LIMITED ON CREDIT RISK MANAGEMENT PRACTICES IN FINANCIAL INSTITUTIONS

We are students of the above named institution carrying out on a topic; ASSESSING CREDIT RISK MANAGEMENT PRACTICES IN MICROFINANCE in partial fulfillment of the requirements for the award of a degree in bachelor of business administration. This is purely for academic purpose, thus you are assured that all information supplied will be treated as confidential. Please respond as honestly and carefully as you can.

QUESTIONNAIRE FOR EMPLOYEE/CREDIT OFFICERS OF FIRST ALLIED SAVINGS AND LOANS (FASL)

ANSWER BY TICKING THE BOX THAT BEST DESCRIBES THE SITUATION IN THE ORGANIZATION.

1. What is your official status in the organization?

Credit officer [ ] Teller [ ] Management [ ]

1. Is there a credit risk management policy document in FASL

   Yes [ ] No [ ]

2. What are the things considered in the drafting of credit policies? 1 =process one, 2 = process 2, 3=process 3

	1	2	3
Customers credit worthiness	[ ]	[ ]	[ ]
Payment Terms	[ ]	[ ]	[ ]
Approval procedures	[ ]	[ ]	[ ]
Procedures to collect outstandings	[ ]	[ ]	[ ]

3. The responsibility for credit risk management is clearly documented and understood throughout the organization

   Agree [ ] Disagree [ ] Not sure [ ]

4. What major risk does the organization face when giving out loans?

   Default Risk [ ] Liability Risk [ ] Interest Rate Risk [ ]

5. How is the risk in question (5) being managed?

Very important [1] Important [2] Less important [3]

	1	2	3
Active loan monitoring	[ ]	[ ]	[ ]
Evaluation of loan project	[ ]	[ ]	[ ]
Education of borrowers	[ ]	[ ]	[ ]

6. Who is responsible for identifying the credit risk faced by the organization
   Tick all that apply
   - Risk Department A [ ]
   - Credit Officer B [ ]
   - Head of Finance C [ ]
   - Credit Risk Manager D [ ]
   - Staff E [ ]

7. Kindly evaluate the risk reducing tools below and evaluate their importance to the bank.
   Very important [1] Important [2] Less important [3]

	1	2	3
Credit granting policy	[ ]	[ ]	[ ]
Internal control	[ ]	[ ]	[ ]
Staff training	[ ]	[ ]	[ ]
Credit scoring models	[ ]	[ ]	[ ]
Debt collection	[ ]	[ ]	[ ]
Client project evaluation	[ ]	[ ]	[ ]

8. According to your institutional policy framework, what is the most cost effective way of lowering your risk exposure?
   Credit granting policy [ ]
   Better loan management system [ ]
   Well trained staff [ ]

9. How well has FASL been in the management of credit risk for the past years?
   Effective [ ] slightly effective [ ] Not effective [ ]

10. Is there a regular training program provided by the organization on credit risk management Yes [ ] No [ ]

11. What is your loan default rate?
    a. 0-10 [ ] b. 11-20 [ ] c. 21-30 [ ] d. 30-above [ ]

12. How regularly do you review your credit policy?
    Quarterly [ ]
    Semiannually [ ]
    Annually [ ]
    If other specify…………………………………………………………………………

13. How would you describe staff knowledge on credit risk management?
    Excellent [ ] Very good [ ] Average [ ] Poor [ ]

14. What are the laid down procedures that are followed in granting credit to client?
    1 =Most effective, 2 = Effective 3=Slightly Effective 4= Least Effective

	1	2	3	4
Appraisal of customer	[ ]	[ ]	[ ]	[ ]
Disbursement	[ ]	[ ]	[ ]	[ ]
Monitoring	[ ]	[ ]	[ ]	[ ]
Recovery	[ ]	[ ]	[ ]	[ ]

15. In case a client defaults, how does the bank get the customer to repay?
    Debit guarantors [ ] Courts [ ] Collateral security [ ]

16. In your own opinion, what is the greatest cause of recent loan default?
    Harsh Economy [ ] Diversion of Funds [ ] Ignorance [ ]

17. Does your bank have a system of verifying client information before loan disbursement?
    Yes [ ] No [ ]

APPENDIX II

INTERVIEW QUESTIONNAIRE FOR CUSTOMERS

1. Age

18-24{ } 25-30 { } 31-35 { } above 35 { }

2. Sex.

Male { } Female { }

3. Are you a client of First Allied Savings and Loans?

Yes { } No { }

4. Number of loans taken from First Allied Savings and Loans:

0-2 { } 3-5{ } more than 5 times { }

5. Number of loans paid with difficulty.

0-2 { } 3-5 { } more than 5 { }

6. Do you always meet the requirements for loans?

Yes { } No { }

7. Does the bank require collateral security before granting loans?

Yes { } No { }

8. Are interest rate charged on loans favorable?

Yes { } No { }

9. Are you able to repay your loan on time?

Yes [} No { }

10. Do you see any flexibility in the payment of loans?

Yes { } No { }