

**CREDIT RISK MANAGEMENT IN FINANCIAL INSTITUTIONS:
A CASE STUDY OF OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS
LIMITED**

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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 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. A purposive sampling technique was used. A pie chart and frequency table use on respondent's questionnaires. In conclusion, the study finds out that the institution falls short in getting detailed information about the credit worthiness of their clients. Also there were no proper checks on properties and documentations of collateral. Again it was found out that the banks dealings with the defaulters of loans falls largely on the shoulders of the loans and relationship officers. The recommendations to these findings are divided into three parts; Pre lending recommendation, credit monitoring and work out strategies. Some of the recommendations include:

1. The bank should do a background check to see whether all the information provided by the borrower is adequate and reliable to trace him if necessary
2. The institution should ensure that the borrower does not invest the money in an industry of distress.
3. The institution should encourage recovery team by rewarding them with cash, other facilities as per how much money they recover and how quickly

The study reviews pragmatic measures financial institutions put in place to reduce loan defaults to its minimum.

DEDICATION

To our mums and dads

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CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF THE STUDY

Financial institutions are companies that provide financial and non financial services to assist individuals and organizations in their monetary and other non monetary issues. Financial institutions consist of three primary groups and these are the savers (the surplus unit), borrowers (the deficit units) and the lenders (financial institutions).

Financial institutions play major role in the management of any economy. They provide the positive functions of bearing and managing risk on behalf of their clients through the pooling of risk specialists like brokers, financial institutions, intermediaries between savers and borrowers by collecting cash deposits from the surplus unit and lending them out to the deficit unit. They serve as capital and debt markets and responsible for transferring funds from investors to companies in need of those funds. Financial institutions facilitate the flow of money through the economy.

Broadly speaking, there are three major types of financial institutions and these are

- Deposit financial institutions. These are the institutions that accept and manage deposits and give out loans, including banks, building societies, credit unions, trust companies, and mortgage loan companies.
- Insurance companies who are in the insurance and assurance businesses.
- Brokers, underwriters, and investment funds.

According to (GHANA BANKING REPORT 2010) Banking is a highly regulated industry and therefore government restrictions on financial activities by bank have varied over time and location. The current set of global bank capital standard is called Basel II. During the

early periods, although banking business was done by private individuals, many countries established public banks for the purpose of facilitating commerce or to serve government.

From the period 1880, when banking was formerly introduced in Ghana (the then Gold Coast), and until coming into effect of the Universal Banking concept in 2003, banks were classified into Commercial Banks, Development Banks and Merchant Banks. This categorisation was based on the chosen line of banking business presented to the Bank of Ghana by each institution.

The structure of the Banking Industry during the Pre-liberalization period was composed of twenty banks with respect to their area operations as follows:

- Bank of Ghana as the regulatory body
- Nine Commercial Banks
- Six Merchant Banks
- Four Development Banks

Financial institutions are increasing in Ghana and not just for investors only but also it is becoming essential for the average family trying to decide how to balance its budgets. They also offer housing and car loans and also assist their clients or customers to buy products on Hire Purchase.

The advent of the new Government, elected by popular vote in 1957, brought the establishment of more banks. Banks incorporated by legislation between the periods, 1957 to 1965 include; the Ghana investment bank as an investing banking institution, the Agricultural Development Bank for the development of agriculture, the Merchant bank for merchant

banking and the Social Security Bank to encourage savings. In conformity with the economic policy of that time, all these institutions were incorporated as state-owned banks.

The banking law was enacted in 1989, enabling suitable locally incorporated bodies to file applications for licenses to operate as banking institution. Subsequently, a number of corporate entities were licensed to operate as banks, including Cal bank, Merchant Bank, EcoBank, Data bank, Stanbic bank, and Fidelity bank.

1.1 FORMS AND IMPORTANCE OF CREDIT

The bank of Ghana credit manual for banks maintains that the credit facilities may be granted for the purpose of conducting or carrying on, developing or improving farm, fishing, industrial and commercial operations to benefit the community. It continues that credit facilities may also be extended to maintain the efficiency of eligible borrowers in connection with their health, education and subsistence. Writing on the importance of the lending function, Crosse and Hempel (1980) argued that, traditionally and practically, the foremost obligation of a bank is to supply the credit need of business enterprises including business operations.

Affirming this stance, Rose and Korari (1995) touched on its significance of quantitative contribution of lending to the bank income, as well as the important role it plays in the social function that the banks perform in the economy.

For a full realization of the above benefit, the banks first type or forms of credit is loan. The second type is the overdrafts. This is the amount a customer is allowed to overdraw over and above his or her normal deposit with the bank. Interest is charged only to the excess amount

over the deposit. It is usually granted to the current account holders. In addition, Valentine and McCarthy (1995) further observed, discounting bill as a third form of credit. When a holder of a bill wants money from his bank and collects the money the amount he will collect from his bankers is less than the face value of the bill. The difference is a fee charged by the bank called discounting charges for performing such services.

All these points above come to support the fact that credit risk management is very important to a banks survival as well as the customers. If the risk associated with lending is greatly reduced, the banks will be relieved of the burden of carrying and using part of their profits to pay off bad debts and the interest of banks in granting credit will rise thereby bringing down the interest on loans and other forms of credit.

The researchers seek to find appropriate measures and recommendations to be made in this subject area to eradicate some of the problems of Credit Risk management in Opportunity International Savings and Loans limited.

1.2 PROBLEM STATEMENT

Financial institution is an establishment that focuses on dealing with financial transactions (collection and distribution of money), such as investments, loans and deposits and also the offering of other products and non financial services to its clients. The finance industry encompasses a broad range of organizations that deal with the management of money. Among these organizations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

Financial institutions have the primary motive of enhancing the financial welfare of their clients by granting them several types and forms of loans that are available on their desks. However, financial institutions are faced with the problem of employees' turnover in attempt to redeeming their loans granted to their clients (Dr Stephen Addae 2008). Many clients do migrate and change their jobs without informing these financial institutions, which makes it very difficult for the financial institution in question to trace them when they default in the payment of their loans.

This situation of job insecurity gives a headache to financial institutions after granting loans to their clients. One of the most difficult situations and exercises for financial institutions is the cost of monitoring their clients after providing them with their requested loans. It falls on the shoulders of some financial institutions to do a follow-up monitoring whether the loans granted to their clients are used for their intended purposes.

It also costs financial institutions to trace loan defaulters especially when they are difficult to be traced because of the informal settlements and difficult contacts of these clients. This results in high operational expenses by financial institutions. The bank has specific conditions with which they give out loans to their clients for the intended use. However a number of these clients veer off from the particular reason why they were given the facility. Some go to extend of using it for their personal benefit and not what the loan was acquired for.

The above paragraphs give the importance and problems of financial institutions respectively and due to these problems; the institutions have devise ways and means of redeeming themselves from the headache they go through. Most of them have designed credit

management strategies to cater for this headache but how well this strategy works is another problem.

Opportunity International Savings and loans Limited like other financial institutions sees to make profit out of savings mobilization and credit granting function. Being a Savings and Loans company the cost incurred in mobilizing deposits from the widely dispersed customers is very high.

As a result of the above problems, the researchers thought it necessary to research into Credit Risk Management in financial institutions using Opportunity International Savings and Loans as a case study.

1.3 OBJECTIVES OF THE STUDY

- To assess the existing deposit mobilization and credit procedures of Opportunity International Savings and Loans Limited.
- To examine the credit management practices of Opportunity International Savings and loans Limited.
- To find out whether Opportunity International Savings and loans complies with central bank regulations on credit management.
- To identify the problems encountered in recovery of loans granted by Opportunity International Savings and Loans Limited.

1.4 RESEARCH QUESTIONS

- What are the existing deposit mobilization and credit procedures of Opportunity International Savings and Loans Limited?
- What are the credit management practices of Opportunity International Savings and Loans?
- How effective is the central banks monitoring and control on Opportunity International Savings and loans?
- What are the problems encountered in recovery of loans granted to customers?

1.5 SCOPE OF THE RESEARCH

The study will be limited to the management of the credit department of Opportunity International Savings and Loans. In the case of attaining the objectives of the study, we will undertake a thorough survey and study the various stakeholders (staff of the bank) views about the credit issues of the bank.

1.6 SIGNIFICANCE OF THE STUDY

To know the lending procedures being used by Opportunity International Savings and Loans Limited.

- Why some customers fail to pay back the loans granted to them.
- The influence of board members and other staff in granting loans

1.7 JUSTIFICATION OF THE STUDY

This study holds tremendous significance to the researchers and the financial institution (Opportunity international Savings and Loans Limited). In the case of the researchers, the project is a pre requisite for the partial fulfilment for the award of Bachelor of Business

Administration. The study will also serve as a base for further research for students, consultants and others who are interested in the study of this subject area and similar topics.

On the other hand Opportunity International Savings and Loans and other financial institutions and banks will improve on how to manage their credit risk based on the recommendations we will make on this research.

1.8 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 will be 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 may feel 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.

1.9 ORGANIZATION OF THE CHAPTERS

The study would be organized into five main chapters, which are summarized below. The first chapter would focus on the introduction of the study and give a background of the study, problem statement, objectives, justification, scope and limitation of the study.

The second chapter would deal with literatures that are related to the topic and background of Opportunity International Savings and Loans limited and how financial institution such as Opportunity International Savings and Loans Limited manages its credit risk. It involves definition of credit risk management, how financial institutions give out credit facilities and also how they manage the credit given.

Chapter three will cover the methodology of the study, concept of the study and the conceptual model of the study, the sample size, population. The chapter also would involve the instruments that will be used to collect data from Opportunity International Savings and Loans as well as the bank profile.

Chapter four would concentrate on the data that have been analyzed, organized and illustrated with the use of appropriate tables and figures. Here, the results of the data analysis would be discussed in the context of the study objectives.

The last chapter embodies summary of findings, recommendations and conclusion of the study which will be chapter five.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews the body of literature on the subject matter of Credit Risk Management. It presents the report on the previous work that others have done in the area under research. It also looks at the regulatory framework of Opportunity International Savings and Loans Limited and the general principles and procedures as well as management of risk.

Credit is an integral part of all phases of Ghanaian life and its importance will continue to grow into the 21st century. It has contributed to the development of the Ghanaian economy and to high standard of living enjoyed by most Ghanaians.

Credit is a familiar social invention that we use freely. As a result, it is essential for the financial institutions to examine the problems that can be encountered after the release of credit facilities, hence the management of risk and problem loans management.

2.1 WHAT IS CREDIT RISK?

Credit Risk is an investor's risk of loss arising from a borrower who does not make payments as promised. It also refers to the risk that a borrower will default on any type of debt by failing to make payment which it is obligated to do. The risk is primarily that of the lender and includes lost principal and interest, disruption to cash flows and increased collection cost. The loss may be complete or partial and can arise in a number of circumstances, for example a customer may fail to make a payment due on a mortgage loan, credit card, line of credit or other loans.

2.2 THE CURRENT STATE OF NON BANKING INDUSTRY IN GHANA

The Ghana Banking Survey 2010 has noted that the liquidity and capital base of banks in the country had improved compared to previous years. However, at the same time, quality of bank loan book had deteriorated and industry profitability declined, said the publication, a joint collaboration of PricewaterhouseCoopers (PwC) and Ghana Association of Bankers. The survey aims to provide general information on Ghana's formal banking sector and the performance of banks operating in the country for the period between 2007 and 2009. The banks' annual reports and audited financial statements for 2007 to 2009 were analysed. Twenty-five out of the 26 banks currently operating in the country participated in this year's survey.

A number of banks have already complied with the minimum capital requirement mandated by Bank of Ghana with others planning on achieving the set target by the end of 2012. Mr Oseini Amui, Director of PwC Assurance, said focus of the survey was a review of how the banks were managing risks in the face of increased capitalization. He said the last three years saw total shareholders' funds for the industry more than doubled from GH¢792 million to GH¢1.8 billion as banks injected new capital and retained earnings to meet the minimum capital requirements.

In the last five years the Ghanaian banking industry has seen a phenomenal growth arising from capital injection by existing banks to meet minimum regulatory capital requirements. The survey indicated that the current sustained economic reforms and stability, improvements in budget deficit, and the new oil find would attract foreign investments and lead to buoyant economic activity. "The appetite for credit would increase and banks should focus on developing an efficient, effective, and flexible banking infrastructure to ensure growth," it said.

Mr Amui Director of PricewaterhouseCoopers (PwC) Assurance said the stable macro-economic trends would encourage savings and with the private sector entering into the pensions market, individual pension contributions would provide another source of funds for financial institutions.

"This would skew revenue opportunities for financial institutions towards savings and wealth management products and away from lending products," he added. Notwithstanding this phenomenal growth, high interest rates continued to be a major concern for borrowers. Financial Institutions are being called upon to justify such high interest rate regime in the country. However, increased competition, growing customer demands, and new regulations are likely to continue to add complexity to business models of banks and information technology environments.

The increased default in payment has been attributed to the unfavourable macro-economic conditions that prevailed for most of the year and perhaps not so good credit decisions made by financial institutions in prior years.

Over time, technology has increased in importance in Ghanaian financial institutions. Traditionally, financial institutions have always sought media through which they would serve their clients more cost-effectively as well as increase the utility to their clientele. Their main concern has been to serve clients more conveniently, and in the process increase profits and competitiveness. Electronic and communications technologies have been used extensively for many years to advance agenda of these financial institutions.

In Ghana, the earliest forms of electronic and communications technologies used were mainly office automation devices. Telephones, telex and facsimile were employed to speed up and

make more efficient, the process of servicing clients. For decades, they remained the main information and communication technologies used for transacting bank business.

Later in the 1980s, as competition intensified and the personal computer (PC) got proletarian, Ghanaian banks began to use them in back-office operations and later tellers used them to service clients. Advancements in computer technology saw the banks networking their branches and operations thereby making the one-branch philosophy a reality. Barclays Bank (GH.) and Standard Chartered Bank (GH.) pioneered this very important electronic novelty, which changed the banking landscape in the country.

Arguably, the most revolutionary electronic innovation in this country and the world over has been the ATM. In Ghana, banks with ATM often have them networked and this has increased their utility to customers. The Trust Bank Ghana, in 1995 installed the first ATM. Not long after, most of the major banks began their ATM networks at competitive positions. Ghana Commercial Bank started its ATM offering in 2001 in collaboration with Agricultural Development Bank. Most banks currently operate ATMs in Ghana. The ATM has been the most successful delivery medium for consumer banking in this country. Customers consider it as important in their choice of banks, and banks that delayed the implementation of their ATM systems, have suffered irreparably. ATMs have been able to entrench the one-branch philosophy in this country, by being networked, so people do not necessarily have to go to their branch to do some banking.

Another technological innovation in Ghanaian banking is the various electronic cards, which the banks have developed over the years. The first major cash card is a product of Social Security Bank introduced in May 1997. Their card, 'Sika Card' is a value card, onto which a

cash amount is electronically loaded. In the earlier part of year 2001 Standard Chartered Bank launched the first ever debit card in this country.

Its functions have recently been integrated with the customers' ATM cards, which have increased its availability to the public since a separate application process is not needed to access it. A consortium of three banks (Eco Bank, Cal Bank and The Trust Bank) introduced a further development in electronic cards in November 2001, called 'E-Card'. This card is online in real time, so anytime a client uses the card, or changes occur in their account balance, their card automatically reflects the change.

Though ATMs have enjoyed great success because of their great utility, it has been recognized that it is possible for banks to improve their competitive stance and profitability by providing their clients with even more convenience. Once again ICT was what saved the day, making it possible for home and office banking services to become a reality. In Ghana, some banks started to offer PC banking services, mainly to corporate clients.

The banks provide the customers with the proprietary software, which they use to access their bank accounts, sometimes via the World Wide Web (WWW). This is on a more limited scale though, as it has been targeted largely at corporate clients. Ghana Commercial Bank, Cal bank (GH.) Ltd and Barclays Bank (GH.) Ltd and Stanbic Bank (GH.) are the main banks known to offer PC banking services. Banks have recognized the internet as representing an opportunity to increase profits and their competitiveness. Currently, no bank is offering internet banking (i-banking) in Ghana, but some have well laid plans to start.

Telephone banking, has also taken a big leap with its convenience and time. Barclays Bank (GH.) launched its telephone banking services in August 28, 2002. GSSB Bank also launched its “Sikatel” or “GSSB Call Centre” (telephone banking) in September 19, 2002. The services available with this system are ascertaining credible information about the bank’s products, the customers’ complaints, bank statements and cheque book request and any other complaints and inquiry.

2.3 PROBLEM LOANS AND ASYMMETRICAL INFORMATION

Although the problem of economics of Information and the special issue of asymmetric information was debated by early economists such as Adam Smith (1776), Simonde (1814), John Stuart (1848), Alfred Mashall (1890) and Max Weber (1925). The most famous paper on the topic “market for lemons” of Akerlof (1970). In this study, Akerlof notes that asymmetric information exists when one side of the market possesses information lacked by other players in that market.

Other authors referred to other markets in which asymmetric information operates. Spence (1973) applied information asymmetry to the labour that a job applicant knows more about his skills than the employer. Another example is insurance company with a relatively inadequate knowledge about a potential client.

Asymmetric information between the bank (as lender) and the investor (as borrower) about which the actual characteristics of the investment being made, coupled with the instability of the global environment lead to problem loans management. Assuming the hypothesis of the efficiency of the condition, only significant factor worth considering is information

asymmetry. This leads us to the moral hazard condition and consequences of the attempt to overcome information asymmetry.

2.4 RISK ASSOCIATED WITH LENDING

Like all other investments, lending cannot pass without some level of risk. Therefore, Clark (1999) defines risk as the amount one potentially stands to lose by a transaction.

Saunders 2002 identifies five different types of risk associated with the operations of any financial institution. These are, market risk, interest rate risk, credit risk, foreign exchange risk and liquidity risk. Out of these, the researcher picked credit risk as the most important of all which the study is also centered on.

Lidgerwood (1993) identifies five different types of risk associated with the operation of any financial institutions. These are

- Credit risk
- Interest risk
- Foreign exchange risk
- Capital adequacy risk
- Fiduciary risk

Out of these, she picked credit risk as the most important of all and according to Rose and Korari (1995), credit risk is the possibility that borrowers will default in repaying loans taken. The general fact that risk is unavoidable in any investment of any sort is well accepted.

Credit risk is defined by Anthony Saunders as “the risk that the promised cash flows from loans and securities held by financial institutions may not be paid in full”. Financial institutions that make loans of long term maturities are more exposed than those who make short term maturity loans.

Van Greuning and Bratan (2000) defined credit risk to mean that payment may be delayed or ultimately not paid at all which can in turn cause cash flow problems and affect a bank's liquidity. From the researcher's point of view, credit risk is the risk of loss that might occur if one party to an exchange fails to honour the terms under which the exchange was to take place.

2.5 CREDIT MANAGEMENT

Forth (1996) contends that any attempt to define management is doomed to failure, mainly because it is diverse and continually changes. Despite that there have been several attempts by various authors to give their own definition.

Stoner and Freeman (1995) defined management as the process of planning, organizing, leading and controlling the work of organizations members and using all available organizational resources to reach a stated goal. Megginson, Trueblood and Rose (1985) also define management as an economic concept. Basically, it is a process of working through respondents to achieve objectives by means of effective decision making, and efficient allocation of scarce resources. Relating the above to the context of Financial Institutions, Hempel, Simonson and Coleman (1994) believe that whatever the degree of risk taken, loans losses could be minimized by organizing and managing the lending function in a high professional manner.

To sum up, credit management could be as a systematic planning and organizing of all available defined Bank resources to grant credit in highly professional manner by directing such credit to various sectors of the economy, so that profitability and the economy's ultimate security of the bank asset are not sacrificed.

2.6 SOUND CREDIT RISK MANAGEMENT CRITERIA

Up to this point the literature review has focused on some global perspective and factors relating to the internal workings of corporate systems and how they impact on loans management. Despite the absence of consensus of internationally agreed standards, significant strands run through the prescriptions of lending financial institutions. From the preceding literature, it appears a sound credit risk management constitutes the framework within which credit applications are processed and as aforesaid, it can sometimes be chargeable for problem loans occurrences. Credit risk management can also be based on these two pillars;

Loans classification and provisioning; it is particularly important because it crops out mechanism to classify loans by degree of riskiness and develop specific remedial management strategies. Remedial management; key actions to be made and strategies to be developed at each stage of the remedial management process.

2.7 CREDIT RISK MANAGEMENT

As defined by Clare (1999) Credit Risk Management is, “the control and supervision of a company as distinct from the work force”. From the researchers own definition, management is the process of planning, organizing, directing and controlling the work of the organization members and using all available organizational resources to achieve the set goal.

In all, credit management by financial institutions is putting measures in place to ensure they meet their objectives thus, satisfying their customers and making adequate profit. Effective credit risk management is about developing consistency in credit granting and collection

process. The effectiveness of a firm's management is often of vital importance to its performance and management is therefore sometimes taken as a factor of production.

These are some of the criteria a good credit risk management system must have as recommended by the ICBC.

Pre lending controls:

¾ detailed credit policy and management rules

¾ internal rating systems to assess risk

¾ centralized review of customers credit limits

On lending controls:

¾ authorization management

¾ approval of credit business

Post lending controls:

¾ credit monitoring

¾ field inspection

2.8 LOANS CLASSIFICATION AND PROVISIONING

A good loan classification system looks like the following one, regardless of the name to the different classes.

CLASSIFICATION	LOAN CLASSIFICATION SYSTEM
Class A	Debts fully secured by cash collateral even if overdue. Borrowers are up to date in repayments. Debts above suspicion overdue for less than 1 month
Class B	Debts overdue for a period between 1 month and 3 months.

Class C	Debts overdue for a period between 3 months and 6 months
Class D	Debts overdue for a period between 6 months and 12 months
Class E	Debts overdue for a period above 1 year.

In the above classification system does not emphasize on the perception of future events concerning the borrower's financial situation by the analyst, as did many organizations recommendations. We considered that appreciation of future events could vary from person to person and can lead to different classifications of the same asset.

Intervals have been provided for provisions so that problem loans can make levels of provisions for assets classified in the same category but with different probable failure

2.9 REMEDIAL MANAGEMENT OF LOANS

We consider that remedial management strategies depend on assets classification. At each stage, a new strategy must be deployed.

CLASSIFICATION	REMEDIAL MANAGEMENT STRATEGIES
Class A	Maintain and improve relationship. Friendly remind the borrower (if debt is overdue)
Class B	Require more collateral to secure the loan. Require a short term repayment schedule from the borrower or restructure the loan if the borrower is not likely to repay within 3 months
Class C	Require a short term repayment schedule from the borrower or restructure the loan if the borrower is not likely to repay within 6 months
Class D	Exit the business by selling collateral and/or taking legal action.
Class E	Exit the business by selling collateral and /or legal action

The proposed remedial strategy may appear as rigid but two main reasons for consideration are necessary. Loan recovery is extremely time-consuming especially when the borrower is unwilling to repay. It may also draw staff member's attention away from other tasks and more lucrative businesses.

The long follow-up process involving telephone calls and transportation fees particularly if the borrower is not in the same geographical area can make the loan recovery be very problematic. Attorney fees can also burden the bank especially when it resorts to a legal course in collecting the money.

2.9.1 Credit Analysis Appraisal

This talks about the process of deciding whether or not to extend credit to a given customer. Base on this, Kapoor et al, (2001) outlined five traits that must be used for such analysis which is referred to as the five C's, namely, character, capacity, capital, collateral and conditions.

- Character is the borrower's attitude towards credit obligation. Most credit managers considers character as the most important factor in predicting whether loan repayment will be made timely and ultimately.
- Capacity is the borrower's ability to meet credit obligation. That is to make regular loan payment as scheduled in the credit agreement. The borrower's income and expenses are considered before credit approval.
- Capital is also the borrower's assets or net worth. Generally the greater the capital, the greater the ability to repay a loan.
- Collateral is an asset that is used to pledge to obtain a loan. The asset is taken over if the borrower fails to honor the terms of agreement.

- Conditions means the general economic conditions that can affect the ability to repay a loan. The questions focus on security of both the job and the firm that employs the borrower.

Apart from five Cs, other appraisal methods are use which CAMPARI is one of them.

CAMPARI is also considered as analysis appraisal for financial institution currently. This lending model is also use in accessing clients who wishes to apply for financial facilities. This model gives a broader view than the five Cs.

In lending to a customer, a logical approach can be followed by taking each important factor in the lending proposition and whether the lending proposition satisfies certain criteria.

The following are the principles to apply to a lending proposition:

CHARACTER: the character involves a lot of background information about the clients and this involves the following. The background and experience of the individuals or business can be a pointer to the potential for success. This includes integrity, past performance, and evidence of financial acumen. No business proposition can be viewed in isolation from the people who will put it into action, and the bank manager will scrutinize both closely the following:

Age/health – this involve the age of the clients and his/her health conditions.

Personal stability – types of occupation, how long the borrower has been in employment, what they hold, etc.

Integrity and Honesty – lenders should check the bank records to find out how well previous borrowings have been repaid and how long the client has been known to the bank.

Personal resources - very difficult to establish this but interview of client visit to home or work place might help

Outsourcing – the indicators will be the lifestyle of the client and his/her regular expenditure. Bank records will reveal evidence of standing orders, hire purchase commitment

Connections - The clients may be key business influencer introducing several new accounts to the bank. There might also be strong family connections.

However, if repayment of the loan facility is doubtful, no matter how strong the connections are, proposition should be declined.

ABILITY: For individual clients, ability and character are more or less the same since a person of good character should be able to manage his/her affairs satisfactorily.

However, for business clients it is important to assess the ability to manage the affairs of the business. Clients should have the requisite skills to run the business and the likelihood of the business being able to repay the loan. This will often depend on the skills and abilities of the owners. On the personal side, intelligence, training and determination should all be considered.

On the business front, the bank will look at profitability, capital requirements, and above all cash flow of the business.

MARGIN: The bank will decide on remuneration or return .i.e. interest rate, arrangement and commitment fee etc. this however depends on how risky they perceive the clients to be.

PURPOSE: - The purpose of the lending must be legal e.g. working capital, personal loan. It must not be used for purposes against government and bank of Ghana regulations. Explain in detail why you wish to borrow money. The bank will want to know that you have thought it through, and that it seems feasible.

The banker may comment on your purpose in general terms. Remember that you ought to

know far more about your type of business than any banker, and treat any advice accordingly. Bankers can offer you knowledge of business theory but they have no practical experience of running their own businesses. However, the bank should tell you whether the form of finance you have asked for is the most suitable.

AMOUNT: The bank would establish the correctness of the amount after all other considerations have been taken into account e.g. in the case of a house purchase, clients should allow for solicitors fees, stamp duty etc.

REPAYMENT: They must be certain about the repayment source. You will usually need to fill in the bank's cash flow forecast forms, to show that your business can afford repayments on the amount you wish to borrow. Many lending schemes offer reducing loans over an agreed period and have fixed rate of interest. If you are borrowing on overdraft, the bank will set the interest rate to reflect its view of the risk - and what it thinks it can get.

INSURANCE: This is called collateral security. It is a safety net against unforeseen circumstances or when things go wrong. Risk takes us to insurance. The bank may ask if security is available and may also ask you to consider taking out insurance cover, against illness for instance. Illness of a key player can be a major risk to a new business.

The bank might consider whether life, accident and sickness and other insurance products might be helpful for both the client and bank benefit.

These factors must be considered so as to reduce risk to the minimum and to ensure the desired profitability of the bank.

2.10 THE REGULATORY FRAMEWORK OF FINANCIAL INSTITUTIONS

Various statutes, regulations and the common law control the forms and functioning of financial institutions. Among the mass of the written laws, those which affect banks are;

- Companies code of 1963 (Act 179)

- Banking act of 1970 (Act 339)
- The Bank of Ghana act of 1963 (Act 182)
- The Bank regulations of 1973.

2.11 PROBLEM LOANS AND EARLY WARNING SIGNS

In order to prevent borrowers' bankruptcy, banks developed insolvency forecasting model. Altman (1968) was the first to design an insolvency forecasting model on discriminate analysis. He studied five financial ratios of 66 American companies and built function to forecast the defeasance of a company. He studied 22 ratios (liquidity, solvency) taken from the most frequently used by American banks to assess the creditworthiness of companies.

His model was as follows;

$$Z = 0.012x_1 + 0.014x_2 + 0.033x_3 + 0.006x_4 + 0.999x_5$$

Where x_1 = working /total of assets

x_2 = reserves/ total liabilities

x_3 = EBIT / total of assets

x_4 = market value of shares/total of debts

x_5 = turnover/total of assets.

The forecasting model was reliable at 80% for only one and sometimes two years. Above timeline the model became reliable only at 40%.

Another study on a sample of 111 Companies by Altman, Haldeman and Narayanan (1977) led to the Zeta model. The Altman model was improved later by Conan and Holder (1979) and by the Benque de France (1983).

Such models are highly reliable since they are built from companies operating in the same sector and have similarities of financial structure.

2.12 EARNINGS BEFORE INTEREST AND TAX

Other methods were used to forecast insolvencies such as logistic regressions (Boisselier); a neuronal approach was also developed (Beauville and Zollinger, 1995). Most of these models were assuming that a scanning of a company's financial statement five years before could predict its failure. Other authors criticized these models arguing that non-financial information were relevant in credit rating models (Grunert, Norden) and that banks were reluctant to let them drive by a mechanist model (Treacy and Carey).

Despite all the critical notes, early warning systems are still growing since the Basel 2 committee encouraged banks to build internal ratings- bases (IRB) systems. Those systems are based upon the banks own estimations of credit risk. The risk component measurement of the probability of default (PD), loss given default (LED) and exposure qualitative information and even if they cannot eliminate problem loans, they remain relevant tool of decision-making. All these models were applied on banks' lending activities to provide a solution to those problem loans. Unfortunately, banks still face problem loans.

2.13 MONITORING AND SUPERVISION OF BANKS BY THE CENTRAL BANK

In the course of business, banks and non banks are subjected to bank of Ghana's supervision. The Bank of Ghana Act 1963(Act182) and the Banking Act of 1970(Act339) empowers the bank of Ghana to supervise the activities of the banks. Supervision is in the form of demanding periodic submission of returns to the Registrar General's office and regular visit by Bank of Ghana's officials.

Financial Institutions are therefore, expected to submit their statement of assets and liabilities and returns on loans and overdrafts. The Companies' Act also requires the banks to prepare and submit to the Registrar General names of its Board of Directors.

2.14 REGISTRATION OF BANKS

With the completion of the acquisition of capital, business premises and drafting of the regulation, the bank, which is often in accordance with section 14 of the company's code?

Upon registration, the registrar will issue a certificate of incorporation, with is inclusive evidence that all the requirement of the code in respect of registration has been complied and that the banks have duly registered under the code.

After the incorporation, the promoters of the banks apply for a banking license from the Bank of Ghana in fulfilment of the requirement under section 2(1) of the banking Act of 1970(ACT339).

From here, the bank is required under section 27 of the companies' code of 1963(ACT179) to obtain a certificate to commence business from the registrar general's office. This certificate empowers banks to start operations. (Dr. Kwaku Addeah, 1989).

2.15 THE CREDIT FUNCTION OF THE BANKS

The banks are obliged to grant credit for viable project within the community in which they operate. Aside this, the Bank of Ghana credit manual for rural banks outline other objectives of the banks. These are savings mobilization, profit mobilization and it plans to raise the standard of living of its customers. The manual further specifies certain requirement that must be fulfilled by the applicant. Firstly, the applicant must be a customer of the bank for at least six months, holding either a savings or current account. The personal traits of the applicant

must be accessed before given out credit. These are: Honesty, Integrity and reputation of the applicant in the community.

Secondly is the progressing competence which must be demonstrated. The applicant must appear to be physically and mentally sound, and possess an unquestionable history regarding loan payment.

Finally, the applicant must show actual need for the credit by a convincing description of the purpose for which the credit facility is applied actual amount and the period the facility is needed must be specified. The applicant is also expected to explain the success for which repayment shall be made. For group loan, they must satisfy the above requirement and the rest who do not possess account must open saving account together with the loan application of the group. For government agencies and members of board of directors of banks such applicant shall be referred to the Bank of Ghana for clearance.

Agricultural Loan: For a farmer or an organized group of farmers who are cultivating land allocated for the cultivation of vegetables and staple crops the acre age under cultivation should not exceed ten acre and hundred respectively.

Industrial Loans: The applicant must be an operator of a rural based industry or producing those good and commodities, which have a ready market within or outside the community.

Commercial Overdraft: The applicant should be a retailer or a wholesaler merchant known in the community and operating a current account with the bank.

2.16 PROCEDURE INVOLVED IN LENDING

Gup Fraser and Korari (1989) maintained that, failure is usually the result of reckless lending, lack of diversification or both. To this end Hempel, Simonson and Coleman (1994) wrote that: effective organization and control of the lending function are vital to the profitability and solution of every bank.

Writing in support of the need for proper lending procedures, Cores and Hempel (1990) recommended the formulation and implementation of sound lending policies and so considered these to be among the most important responsibilities of bank directors and management.

On their part, Rose and Korari (1995) believed that before establishing a loan policy, the institutions needs to be concerned about how individual applicants are evaluated.

2.17 LOAN POLICY

Rose and Korari (1995) outlined the following components: objectives: development and re-examination of loan policy provide directors with the opportunity to evaluate the role of the bank in community economic development its support to business and other important issues.

2.17.1 Trade Areas

Both primary and secondary areas should be designed to instruct loan officers, on the banks geographic priorities. The bank should define the area to be serviced routinely by each officer. Set limit on loan participation with other bank customers outside the area, process any other loans as an exception to policy (Hempel, Simonson and Coleman).

2.17.2 Loan Mix

The mix of credit that the bank is to emphasize and what might be an appropriate balance of each type of loan in the portfolio needs to be specified. Such specifications should be made with regards to the demand of the local economy, as well as the size of the bank and expertise of its management (Rose and Korari 1995).

2.17.3 Loan Pricing

An important issue concerning how to adjust the rate charged as perceived risk of the loan varies one possibility is to group loan in to risk category. (Rose and Korari 1995).

2.17.4 Credit Standards

Loan policy should indicate both desirable and undesirable types of collateral. It should further indicate circumstances in which unsecured lending is prohibited. The quality and liquidity of collateral must be verified and maximum loan collateral value ratio should be applied before a secure loan is approved. Hempel, Simonson and Coleman, 1994.

2.17.5 Loan Authorities and Approval

The policy should establish lending for all loan officers and for combination of officers and loan committees. Hempel, Simonson and Coleman, 1994.

2.18 CREDIT ANALYSIS APPRAISAL

According to Maness (1998), to talk of credit analysis is to talk of the process of deciding whether or not to extend credit to a given customer. He outlines certain individual traits that must be used for such analysis, which is referred to as the five C's. Namely, the customer's

character, capacity to pay, collateral to support to ensure the granting of good loans easy recovery, as well as reduce to barest minimum the risk associated with lending.

2.19 LOAN REVIEW AND EVALUATION

Loan review: in general, suggested, Hempel, Simonson and Coleman (1994), the loan policy should require diligence on the part of all loan personnel to detect and attempt to correct problems. They further identified certain indicators to aid loan officers in the detection of problem loans. These include in deposit balance and occurrence of overdrafts late payment of principal and interest, and delays in the submission of periodic financial statements. Crosse and Hempel (1980) also emphasized the need for periodic credit review by both large and small banks. They noted that at the heart of the function, is the credit file, the banks written records of its investigation borrows and its business transaction with him. That it shall amount to a very bad practice should the best loan officer be allowed by the directors of the banks to review loan made. Assign a reason for this they acknowledge the possibility of taking certain vital facts for granted to over enthusiasm.

CHAPTER THREE

METHODOLOGY AND ORGANISATION PROFILE

3.0 INTRODUCTION

This chapter focuses 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 of Opportunity International Savings and Loans Limited.

3.1 RESEARCH FRAMEWORK

The case type of research which enables an aspect of a problem to be studied in detail within a time frame was used for the research and collection of data for the research was by the use of questionnaires and interviews.

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 the semi-structured type of interview where the interviewer works out a set of questions in advance and later modifies them based on the perception of what seem appropriate in the context of the conversation was used in collecting information from the heads of the credit department.

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 utilised which has a bearing on the topic included reports and other documents on the operations of Opportunity International Savings and Loans Limited as well as from journals. In addition, certain books of records containing the types of customer credit granted, defaulting credit beneficiaries and those who honoured their credit were willingly released to the researcher. This served as support for whatever information that has been obtained from the bank.

3.3 SAMPLE POPULATION AND SIZE

The population of this research was the staff of Opportunity International Savings and Loans, Maakro branch (Kumasi). The research topic of this study is to find out how credit risk is managed in financial institutions and we narrowed ourselves to how Opportunity International Savings and Loans Limited, Maakro branch manages its credit. Based on this, the researchers used the staff members of the credit department of the Maakro Branch and heads of the credit department in three (3) different branches including the Maakro branch as the population.

3.3.1 Sampling Techniques

A purposive sampling technique which refers to selecting respondents directly related to an activity was used for the study. For the purpose of our research the relationship officers were contacted since they were responsible for the information required.

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 its appeal in allowing respondent to provide answers at their own convenience.

3.4.2 Interviews

The researcher used the semi-structured type of interview and personal conversation in conducting the research. This was carried between the researchers and the relationship officers of the bank.

3.5 METHODS OF DATA ANALYSIS

After reviewing the data collected, the two types of data analysis procedures, qualitative and quantitative analysis were employed to analyse the data collected.

Due to the nature of our data collected SPSS and other computer statistical tools were not used.

3.6 ORGANISATIONAL PROFILE (OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS LIMITED)

Brief History

Opportunity International Savings and Loans Limited as a leading micro finance institution in Ghana and it's a member of the Opportunity Institution Network. Opportunity International Network is a global coalition of organisations with forty seven partners around the world. Opportunity International Savings and Loans Ghana was licensed by the bank of Ghana in 4th June, 2004 and began operation in September, 2004.

Opportunity International Savings and Loans is dedicated to providing financial support to people in less developed countries through a team of dedicated staff working hand in hand with its valued customers. With its highly skilled professional staff, Opportunity International Savings and Loans Limited is committed to seeing lives transformed through delivery of high quality financial and other development products and services that is designed to meet the demands of entrepreneurial poor.

3.6.1 Products and Services

Some of their products and services include;

Demand Deposit

Savings Account

Agro Savings

Time Deposit

Trust Account

Individual Account

Group Account

Educational Loan

Agriculture Loan

Church Loans

CHAPTER FOUR

ANALYSIS AND INTERPRETATION OF DATA

4.0 INTRODUCTION

This chapter applies the framework of Credit Risk Management developed by Opportunity International Savings and Loans Ltd. The idea is to compare the institutions handling of Credit Risk Management with the criteria of the framework. This chapter also embodies the methodologies followed to analyze and interpret data.

The data analysis and its interpretations were focused on the various types of loan facilities that are available to the institutions clients for the year 2012 which include salary' loans, group loans, individual loans, church loans, and other short term loan, medium term loan and finance loans

4.1 TYPES OF LOANS OFFERED BY OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS LTD

With a loan facility, the borrower initially receives or borrows an amount of money, called the principal, from the lender, and is obligated to pay back or repay an equal amount of money to the lender at an agreed time. Typically, the money is paid back in regular installments, or partial repayments; in an annuity, each installment is the same amount or in reducing balance. The loan is generally provided at a cost, referred to as interest on the debt, which provides an incentive for the lender to engage in the loan. In a legal loan, each of these obligations and restrictions are enforced by contract, which can also place the borrower under additional restrictions known as a loan agreement. Although this article focuses on monetary

loans, in practice any material object might be lent.

From our interview with the relationship officers, we were told that, the institution has several loans available to its clients based on different purposes requested by them. Generally they can be grouped into;

- Small Term Loans
- Medium Term Loans
- Long Term/Financing Loans

Aside these loans, based on the customer's request and need other loans also come into the system, some of them are;

- Salary Loans; these are loans that are granted to government employees and other target market of the institution. The target market of the bank means companies who are reputable and their employees' turnover is low. This type of loan is granted as loan facility.
- Group Loans: these are loan facilities granted to a group of people who come together to co-guarantee for each other. The groups are normally between five and fifteen people.
- Individual Loans: These loans are granted to individuals who provide guarantors. The amount ranges between one thousand to ten thousand Ghana Cedis.
- Church Loans: these are loan facilities are granted to registered churches for undertaking major projects such as church buildings, mission houses, purchase of vehicles etc.
- Edu Finance: these are loan facilities granted to proprietors of schools for undertaking major projects, purchase of school vehicles, computers etc.
- SME Loans; these are loans given to mostly registered businesses. The amount

granted ranges from ten thousand and above. Collaterals are normally provided before such loans are granted.

- Goal Loans: Goal loans are loans granted to L300 and final year tertiary students to enable them pay their tuition fees. Parents of such beneficiaries serve as guarantors and payment of the loan granted is made after completion of school.
- Housing loans: these are granted to individuals who want to undertake building projects. The duration of this facility ranges from six to thirty six months. A beneficiary must have a legally acquired land with all the land documents before assessing the loan.

4.2 DESIGN OF LOANS IN OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS

With an interview with the Relationship Manageress, Opportunity International Savings and loans Ltd does have several loan packages that are available for it clients per their requests for those loans. The institution therefore identifies the requested loans into their design perspective in relation to the category of loan. With Opportunity International Savings and Loans, the design of loan is categorized into two, which are:

- Group loans
- Individual loans

The type of loan requested by the client and its repayment period will depict the design under which it falls.

4.2.1 Individual Loan

These loans are granted to individuals who provide guarantors. The amount ranges between one thousand to ten thousand Ghana Cedis. The individual loans may include Small and

Medium Scale Enterprises (SME), Church Loans, Go Loans, Edu Loans, and Housing Loans. Interest is charged on the whole amount that is given to the client.

4.2.2 Group Loans

This type of loan is given to a group of clients between five and fifteen people who are already engage in business. They co-guarantee for each other. Interest is charge on the whole amount and fixed monthly repayment or installment made over a given period. The individual members accounts are credited with their part of the loan facility after satisfying all the requirements of the institution.

Group loans also comprise of Adehye (Royal) loan which is given to a group or member (s) of a group who have successfully completed their forth cycle loans.

4.3 REASONS FOR GRANTING LOANS

Both the institution and the clients have their own perspective of granting and requesting for loans respectively as explained by the Relationship Officer. From the institution perspective, here are some of the reasons why they give out loans to their clients.

- For opportunity savings and loan Ltd our main aim or reason for giving loan is to transform lives.
- It is part of their operating activities. The main function of every financial institution is to serve as a financial intermediary, which links borrowers and lenders together. Opportunity savings and loans as a financial institution projects that, collection of deposits and granting of loans is one of their core activities.
- It serves as an income to the institution. More of the institution's profits are derived from interests generated from loans. Interest and other charges on loans are used to finance the operating expenses of the institution.

- Competition in the banking industry has led to granting of more loans. The introduction of new banks and other financial institutions in the country has forced financial institutions to give out more loans in order to maintain and attract new clients. This has made some banks to flex their requirements for granting loans.

From the clients' perspective, again here are some of the reasons why a client would request for loan from the bank.

- Expansion of business: one of the main reasons why clients would call in for loan is for the expansion of their businesses. Clients go in for these loans to buy additional stocks, new machines, expansion of their premises, creating new business portfolios and working towards new business deals.
- Injection of working capital: clients go in for loans to supplement their working capital since it is likely for a business to become cash trap in the long run. The running of the day-to-day activities in the business depends largely on the existence of enough working capital.
- Meeting contingencies: Businesses secure loans to meet unforeseen contingencies like the clearing of goods imported, paying duties, and settling other contingencies like legal issues and so on.
- Payment of wards fees: some parents or guardians go in for loan facility to pay for their wards fees.
- Construction purpose: some clients take the loans for the purpose of financing their projects. (Housing).

4.4 PROCEDURE FOR GRANTING LOANS.

From the interview with the relationship Officer, he said, opportunity savings and loans Ltd has procedures for granting loans to its clients. These are done in the confines of the rules of Bank of Ghana, which are reviewed as and when necessary.

The Bank of Ghana has laid down procedures for granting loans in the financial institutions and these procedures are strictly monitored.

Opportunity International Savings and Loans has its policies in place for granting loans. It is the policy of the institution to for a credit portfolio manager to satisfy all the procedures before granting or approving of any loan requirement. Among these procedures adopted by opportunity international savings and loans includes;

- Business assessment; opportunity international savings and loans has it's as a policy that all relationship officers do proper assessment of client business or projects, whether clients are engaged in legal business etc. It also has to do with how viable the business is and the value of the business in relation to the amount to be granted as loan.
- Risk department; the risk department of opportunity savings and loans takes the final decision on the loan requested by the business in question that has forwarded all its necessary documents to the business assessment department which when satisfied with all the requirements, lastly forward them to the risk department. The department diagnoses the potential of the business whether it can pay back the loan in the required time.

However, irrespective of the recommendation given by the business department, the risk assessment department upon examining the business thoroughly makes the final decision. They are interested in the risk associated with the business and therefore are very conscious of approving loans to businesses.

The data below shows the various types of loans facilities opportunity savings and loans ltd (Suame , branch) gave out in 2011 with their corresponding bad debt.

TABLE: 2011 LOAN PORTFOLIO OF OPPORTUNITY INTERNATIONAL SAVINGS AND LOANS LIMITED SUAME BRANCH

FACILITIES	AMOUNT GRANTED	BAD DEBT	PERCENTAGE DEBT TO LOANS
	GH¢	GH¢	%
GOAL LOANS	25,787.00	NILL	0%
ADEHYE LOANS	922,282.00	11,067.38	1.2
GROUP LOANS	111,403.00	7,241.20	6.5%
CHURCH LOANS	20,000.00	NIL	0
EDU FINANCE/ LOAN	55,000.00	NIL	0
INDIVIDUAL AND SUSU	101,909.00	6,800.00	6.67
SME LOANS	140,000.00	8,000.00	5.71
SALARY LOAN	4,500.00	NIL	0
TOTAL	1,380,881.00	33,108.58	2.40

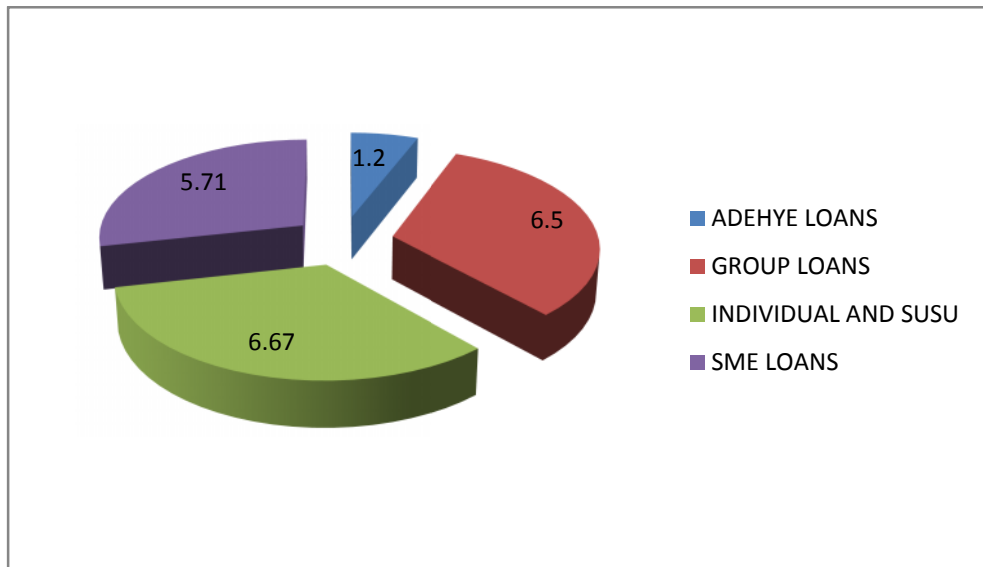


Figure 4.1 Analysis of Bad Debt

4.5 ANALYSIS OF BAD DEBT

The diagram above shows the percentages of loan facilities that resulted in bad debt. In the diagram above, individual and Susu loans had 6.67% of the total bad debt, indicating the difficulty in its redemption or management. Group loans also follow with 6.5%, SME is 5.79%, Adehye 1.2% while all the other forms of loans granted incurred no bad debt. These include Goal Loans, Edu Loans, Church Loans and Salary Loans.

Opportunity International Savings and Loans Limited provide loan facility in various forms to their prospective clients. Amongst all these loan facilities, the institution has the biggest challenge in managing individual and Susu loans alongside SME loans.

The researcher has therefore taken a keen interest in researching about individual loans and SME loans. With an interview with the relationship Officer, the following were explained:

According to him, individual loans normally range from one thousand to ten thousand Ghana Cedis and collaterals are not normally taken before they are granted and when clients default,

they do relocate from their known locations and tracing them becomes difficult. The institution may therefore have to depend on guarantors for payment but if on the other hand the guarantors also could not pay, the facility would have no other option than to resort to the law court for their money. Comparing this to group loans however, group loans are much easier to trace or recover because if a member disappears the other group members may look for him or bear the cost.

Again, he stated that though collaterals are taken for SME loans, they do still go bad because of the huge amounts normally granted. Thus if the client does not pay a greater percentage of the loan before it goes bad, the effect on the loan portfolio is greater. Financial institutions are also faced with the problem of employees' turnover in attempt to redeeming their loans granted to their clients. Many clients do migrate and change their jobs without informing their bankers, which makes it very difficult for the financial institution in question to trace them when they default in the payment of their loans. This situation of job insecurity gives a headache to financial institutions after granting loans to their clients.

In addition, the most difficult situations and exercises for financial institutions is the cost of monitoring their clients after providing them with their requested loans. It falls on the shoulders of some financial institutions to do a follow-up monitoring whether the loans granted to their clients are used for the intended purposes. It also costs financial institutions to trace loan defaulters especially when they are difficult to be traced because of the informal settlements and difficult contacts of these clients. This results in high operational expenses by financial institutions.

4.6 EARLY WARNING SIGNS OF BAD OR DOUBTFUL DEBT

They refer to the ability of the bank to anticipate, detect, recognize and report problems as early as possible so that prompt corrective actions can be taken to avoid this problem.

From figure 1, it can be noted that the institution experienced bad or doubtful debt as a result of loans granted to its clients. This comes about as a result of the following;

- When deposits cease coming: Loan clients are expected to run their accounts with proceeds from their business. The institution then ensures that regular deposits are made into the account and when these deposits cease coming, it serves as a sign to the institution that the loan could go bad or there could be something wrong with the clients business.
- When installment agreement between the institution and the client is distorted because the client could no longer pay the agreed installment in the specified time interval. The institution therefore expects constant and frequent deposits from clients who have been granted loans. However, if the institution realizes the trend of deposit falling short and not encouraging as expected of them, signifies danger of doubtful debt.
- When clients' cheques are dishonoured continuously, a debt would be going bad when the customer does not have sufficient money in the account to meet the face value of the cheque being issued. The bank does accept cheque payments from their clients as payment of loans granted to them. Sometimes, the clients have business to do with other banks or financial institution. It normally occurs that the cheques that are issued by the client to the institution are always dishonored when the institution goes for clearing. This is a warning sign of the clients' bankruptcy.
- When a client divulges information and does not open up when relationship officers visit him/her; some unscrupulous clients may tend to divulge or issue out some

critical information to the outside world, which may tend to be unhealthy for the institutions competitive environment. Again, when the client does not show concern and care when the officers visit him or her. There are situation where clients are not willing to open up to relationship officers when they visit them. This shows the inability of those clients to pay their loans back.

- Multiple Loans: when it comes to the notice of the institution that a client has taken multiple loans from other banks, it serves as a clear indication of a default or the loan could go bad.

4.7 MEASURES PUT IN PLACE IN MANAGING BAD OR DOUBTFUL DEBT

The Relationship Officer explains in the interview about the loan recovery strategy put in place by institution as follows;

- Insurance on loans. There is always insurance on whatever amount that is granted clients. Clients are made to pay one percent of the loan amount as the insurance premium in case of theft, burglary or fire outbreak in the clients business.
- The institution constantly traces and pressurizes the clients for them to settle their indebtedness with the bank. it is the duty of the institution to exert necessary effort in the collection of loans from their clients by way of constantly calling the client and visiting.
- Relying on guarantors: The institution relies on client's guarantors for payment when the loan goes bad.
- The institution also depends on collaterals used in securing the loan by clients. These collaterals are disposed off to settle the indebtedness in case of bad debt.
- The institution also uses the credit bureau to curb multiple loans by clients. The institution has subscribed to XDS DATA (CREDIT BUREAU) and checks are made

on the clients before loans are granted to see if clients have not taken facilities from any other institution.

- As the last resort, the institution summons defaulters to court for them to be brought to book. The requirement of every transaction must be within the law, and if any default occurs, the bank has the option of taken the client to court for a judgment to be pass.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

The researcher assessed the credit risk management practice of Opportunity International 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 practises 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

Opportunity international 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 requirements. The institution do not go beyond the requirements to have detailed financial business information of the clients to know if they are clean from other financial institutions before granting the loans.

Inadequate information about the clients residential addresses. Most clients do write non-existing addresses and locations on their loan application forms. The institution may not obtain enough information about a clients' residence and addresses. This creates identification and spotting problems for the institution when clients default and there is the need for visitation and check operations.

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.

Inadequate incentives such as car award, fridge, television to motivate recovery team to collect bad or doubtful debt. The recovery team is not motivated enough with the incentives that can motivate them travel miles away to check on defaulters and take the risk of journey on bad roads. The inadequate incentives result in the recovery team giving up on the operation. There are no proper checks on properties and documentations of collateral. Clients may double use a particular property as collateral with other financial institution.

5.2 CONCLUSION

In conclusion, we can say that the assessment of the credit risk management practices of Opportunity International Savings and Loans Limited (Suame Maakro Branch) showed that: The workout strategies for their credit management are satisfactory. Nevertheless, we noted that strategies to sort out some problem loans often took longer periods.

The recommendations we made are mostly based on the credit risk management processes and industry players agree that sound risk management processes can lower loan losses. This shows the importance of having a clear credit policy and procedure manual that should be available and very well understood by any employee of the institution.

The Board of the institution should have an oversight of the risk management and it should be integrated in a day-to-day decision making. The insistence on the role of the credit risk management system in loans management may discourage some banks in taking risks, which should not be so. As aforesaid, risk is inherent to financial institutions particularly lending activities.

The CEO of Unique Trust Bank (UT Bank), asked to explain why banks are not willing to lend to SMS, fingered the "lack of a culture of risk taking". The issue is not to avoid taking risks but to develop a series of controls and 'checkpoints' to evaluate accurately the level of risk to be taken and how bearable it is for the institution. Measurements of performance should no more be limited to traditional accounting measures but should integrate 'risk-adjusted' components.

5.3 RECOMMENDATION

Any worthwhile research suggests relevant and pragmatic approach to help curb the ills, which have been identified by the researcher. The following recommendation can therefore be made to make the research a complete and conclusive one. It is divided in three parts:

Pre-lending; refers to measures that should be taken before granting a loan. They are related not only to the credit activity but also to the overall institutional policies and incentives.

Credit monitoring; this is about the effective follow up of the credit on the continuous basis from disbursement to full repayment of principal and interest.

Workout strategies; will provide strategies to manage and recover problem loans.

5.3.1 Pre-lending Recommendations

Industry risks

Caution should be taken to avoid two kinds of risk related to the industry: Avoid great exposure to a specific industry and have at any time, a clear idea of its exposure to different industries so that if the industry collapses it can manage the trickle down effects. The institution should ensure that the borrower does not invest the money in an industry of distress. In the case of group loans it is advisable that the institution's client/members within a group come from a common industry.

Information System and background check

The institution must have an information system that works properly and efficiently to provide any information such as: Collateral pledged by a borrower is not also pledged in one or many other transactions with other financial institution. This can lead to litigious situations. In case of cross default i.e. if the borrower fails to meet his obligations with another bank. This should normally involve the classification of the borrower at least on a watch list. The bank should do a background check to see whether all the information provided by the borrower is adequate and reliable to trace him if necessary.

Size and Ownership of the Companies

Some small and medium scale companies must be treated with carefulness because as noted they have a higher risk profile. Lending to such companies must not be done before the Bank has the assurance that the companies' shareholders are solvent. Facilities to those companies must mostly be granted to finance specific transactions.

Portfolio Growth Incentives

Generally, credit officers are awarded incentives based on the assets booked. They may not be careful enough to the transactions they recommend to the institution. If relationship officers and other credit officers are awarded based on a “Quality-portfolio-oriented incentives” it will make the Bank have a safety growth of its credit portfolio.

Companies Dealing With Governments

Governments often fail to meet their obligations timely. When lending to companies dealing with Governments the Bank must assume that the likelihood of untimely repayment is high, especially when the repayment of the facility is supposed to be done upon settlement of the transaction with the Government.

5.3.2 Credit Monitoring

Maximum information should be obtained on the borrower’s ability to generate adequate cash flow to service the debt. Sources of such information can be other banks, companies dealing with the borrower (suppliers and clients as well), newspapers. Semi-annual financial statements should be required by the Bank to have a constant opinion on the borrower’s creditworthiness. Visits should be paid to clients to assure the Bank the most accurate information on them.

5.3.3 Work-Out Strategies

5.3.3.1 (a) Effective teamwork

The collection team should include:

An account officer; being the first to get in touch with the client, the account officer is the one supposed to have the maximum information on the borrower. In addition, even if a client

is in financial distress today, he might be a good borrower tomorrow. For that reason, he needs to be treated with care. A Relationship officer; he is responsible for championing the recovery efforts. He is also in charge of restructuring, monitoring and generating appropriate reports. A legal department officer; his role is to assure that all decisions and measures taken in the collection effort are lawful.

5.3.3.2 Incentives

The recovery of a loan is sometimes tiresome and boring especially when it is long overdue. This may discourage the collection team and they may abandon sooner. The way to overcome this problem may be to encourage by rewarding them with cash, other facilities as per how much money they recover and how quickly.

5.3.3.3 Additional Risks

Caution should be taken not to unnecessarily extend more 'good money' to an already stressed relationship with the hope of recovering the 'bad money'. If the continuity of the borrower's activities is the only condition to recover the loan, the Bank may assist the company but only in acceptable limits of risk.

5.3.3.4 External Debt Collectors

We do not advise the bank to carry the collection to external agencies. A 'bad borrower' today may be a 'good borrower' tomorrow and since these agencies have no client relationship to protect, they are likely to act with coercion. In the special case where the institution is obliged to carry the collection effort to an external agency, care should be taken not to abandon the recovery effort to these agents. They should be given specific targets, monitored and require report to the institution.

5.3.3.5 Enforcement of Collateral

The significance of the Collateral as a secondary means of repayment should always be borne in mind during the recovery process. This should influence the bank's corporate disposition and efforts in managing security-related elements in credit structuring: value, type, quality, insurance, documentation deferral and perfection among others. Depending on the psychology of the local market, the actual process of liquidating collateral may have to be initiated to encourage, threaten or induce repayment.

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APPENDIX II
CHRISTIAN SERVICE UNIVERSITY COLLEGE
QUESTIONNAIRE FOR THE CREDIT DEPARTMENT OF OPPORTUNITY
INTERNATIONAL SAVINGS AND LOAN LIMITED ON CREDIT RISK MANAGEMENT
IN FINANCIAL INSTITUTIONS

The research seek to find out the how credit risk is managed in Opportunity International Savings and Loans Limited. The objective of this study is purely for academic work and not in any way an attempt to assess ant financial institution.

You are assured that all information supplied will be treated as confidential. Please respond as honestly and carefully as you can.

Name.....

Sex Male () Female ()

Official status.....

1. Does the bank have any laid down procedures that are followed in granting credit to client?

Yes () No ()

2. What are the laid down procedures?

.....
.....
.....

3. Are the procedures within the regulation of bank of Ghana?

Yes () No ()

4. Do you have any conditions a client is suppose to meet before he/she is given the loan?

Yes () No ()

5. Do you grant loans to anyone who applies for it? Yes () No ()

6. Do you give loans to only clients who have an account with you?

Yes () No ()

why?.....
.....

7. Are all your clients able to satisfy your requirements? Yes () No ()

8. If No to question 7, what are some of the reasons given?

.....
.....
.....

APPENDIX II
SAMPLE QUESTION FOR INTERVIEW

1. What are the types of loan facilities available for your clients?
 - a) Small term loan ()
 - b) Medium term loan ()
 - c) Long term loans ()
 - d) Others()
2. What are some of the reasons why you grant loans to your customers/clients?
 - a).....
 - b).....
 - c).....
3. What are the various procedures for granting each loan facility?
 - a).....
 - b).....
4. How often does the bank review such procedures?
5. What is (are) the type(s) of loan facilities that the bank find it difficult to redeem/monitor?
 - a)individual loan ()
 - b) Group loans ()
 - c) Others.....
6. How long does a client operate with the bank before being granted loan?
7. Do you experience any cases of bad debt/doubtful debt? Yes () No ()
8. What are some of the early signs of bad debt?
9. Do you make any provision for bad debt?
10. What are the current measures put in place in managing bad debt?

APPENDIX C

SAMPLE QUESTIONS FOR CUSTOMERS

1. Have you ever gone for a bank loan/
2. What type of loan did you receive from the bank?

a) Susu Loan () b) Educational loan () c) Group loan()

3. Why did you go for the loan?
4. What was the amount requested for?
5. Were you given the entire amount requested for? Yes () No ()
6. Did you use the loan for its intended purpose? Yes () No()
7. If No, why.....
8. Were you able to pay the loan and the interest within the stipulated time?
9. If No, why?
10. What measures were imposed on you by the bank in order to retrieve the money?