ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

ASSESSEMENT OF THE PRACTICESANDCHALLENGES OF CREDIT RISK MANAGEMENT: A CASE STUDY ON ADDISS CREDIT AND SAVINGINSTITUTION

BY:

SENTAYEHU DESTA

DECEMBER, 2018

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ADVISOR: MARU SHETE (PhD& ASSOC. PROF.)

A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OFGRADUATE STUDIES, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF ART IN PROJECT MANAGMENT

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Approved by the Board of Examiners

Dean, Graduate Studies	**Signature & Date**
Advisor	**Signature & Date**
External Examiner	**Signature & Date**
Internal Examiner	**Signature& Date**

Statement of Declaration

I Sentayehu Desta declare that this research is done with my own effort, and all scholarly materials used in the thesis are duly acknowledged. I have produced it independently except for the guidance and suggestions of my research advisor. I assure that this study has not been submitted for any scholarly award in this or any other university.

Name: Sentayehu Desta

Signature ———————————— Date ——————

Endorsement

I endorsee that Sentayehu Desta has carried out this research work on the topic "Assessment of the practices and challenges of credit risk management in Addis Credit and saving institution" under my supervision.

Advisor Name: Maru Shete (PhD and Assoc. Prof.)

Signature ———————————— Date ——————

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Table of Contents

List of Tables

ACRONYMS AND ABBREVIATIONS

AdCSI - Addis Credit and Saving Institution

CR- Credit Risk

IT- information technology

WOR- Write of Ratio

LGD – Loss Given Default

PAR- Port folioat Risk

MFI- Microfinance Institution

MIX- Microfinance Information Exchange

NBE - National Bank of Ethiopia

NGO - Non-Governmental Organization

TEVT- Technical and vocational training

SPSS –Statistical Package for Social Science

LRM- Loan Review Mechanisms

LLR- Loss Reserve Ratio

Abstract

Credit and saving institutions are not exempted from the challenges that come with credit exposure. Given their importance to the economy, efforts should be made to help the sector deal with the problem of credit risk management. This study, therefore, examined the credit risk management practices and associated challenges in Addis Credit and Saving Institution. The study adopted a descriptive survey research design. The target population of the study consisted of 64 credit service delivery posts in Addis credit and saving institution. Primary data were collected using questionnaires where all pertinent issues regarding credit risk management were addressed. Descriptive statistics were used to analyze the data and results were presented using tables. The study found that shortfalls related to credit risk control, and loan collection policy were among the challenges that were evident while managing credit risk in Addis credit and saving institution. Of these challenges, short falls in credit collection policy was found to be the most critical one in the risk management of the institution. Based on the result the researcher recommends that Addis credit and saving institute should enhance their collection policy by adopting a more stringent policy to a lenient policy for effective debt recovery. Again, the necessary due diligence should be undertaken by credit officers to ensure that collateral properties are not the subject of intense litigation. This will help the bank in the event of default. Further, there is a need to invest on projects linked to credit risk management system that will help to maintain and archive the customer's statistics.

***Keywords**: Credit risk, credit risk control, credit collection policy, client appraisal, Addis credit and saving institution, Ethiopia*

CHAPTER ONE

INTRODUCTION

1.1.Background of the Study

The adequate management of credit risk in financial institutions is critical for the survival and growth of financial institutions. In the case of rural banks, the issue of credit risk is of greater concern because of the higher levels of perceived risk resulting from some of the characteristics of clients and business conditions that they find themselves. Credit risk management is a structured approach to managing uncertainties through risk assessment, development of strategies to manage it and mitigation of risk using managerial resources. The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk (McNaughton, 1996).

Credit risk is defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should also consider the relationships between credit risk and other risks. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization (Greuning & Bratanovic 2009).

According to Hinnies (2003) note, despite innovation in the financial service sector over the years, credit risk is still the major single cause of bank failures, for the reason that more than 80% of a financial institute balance sheet generally related to this aspect of risk management. The consultative paper issued by Basel (1999) also pointed out that the major cause of serious banking problem continuous to be directly due to the loose of credit standards for borrowers and counter parties, poor portfolio risk management and so on. Sustainability in simple terms refers to the long-term continuation of the Microfinance program. It entails that appropriate systems and processes have been put in place that will enable the Microfinance services to be available on a continuous basis and the clients continue to benefit from these services in a routine manner or in the day to day activities. This also would mean that the program would meet the needs of the members through resources raised on their own strength, either from among themselves or from external sources. Sustainability is possible only in the presence of appropriate risk management practices (Guntz, 2010).

For this reason, there are many types of microfinance institutions depending on structure, function or philosophy. In many instances, the microfinance market is segmented according to the clients involved i.e. micro-enterprises, women, agriculturalists and so on. A main goal of many micro finance institutions is to provide sustainable micro finance facilities to the poor to facilitate income generation and reduce poverty (Baumann, 2001). The genesis of this is that the poor lack access to financial services, credit and savings facilities. In addition, getting credit is challenging in that there is discrimination, and there is no transparency as to why one's loan request is accepted while another's is rejected. In addition, the loan given is very small, the collateral required is huge, direct and indirect service payments are high, risk evaluation capacity is inadequate. And the institution has 10 branch offices, in and around Addis Ababa city administration. Despite the broad service of the MFI, considering the time and cost needed to collect data, this study is enclosed to three branch offices (i.e. Addis Ketema, Arada and Gulele branches and head office).

1.2. Statement of the Problem

Credit risk management challenges are implicit in financial institutions (including micro finance institutions) activities because credit risk events are typically uncertain (Laurentis 2009). As Nancy (2001) noted, an effective credit risk management process is required to help institution's top leadership establish rules to prevent operating losses due to human error, employee carelessness, technological malfunction or fraud. To illustrate, a micro finance's management may put into place internal controls and procedures as well as periodic internal audit reviews to ensure that employees comply with rules when performing duties in credit risk management. A credit risk management policy also may cover financial risks of financial institutions.The empirical studies that have been reviewed in the preceding section focused on the different micro finance institutions issues that affect the performance and in effect profitability of micro finances institutions. In addition, most prior studies regarding credit risk management tried to examine the possible methods to manage credit risk including the use of credit score rating, and the impact of borrower's financial positions on credit risk management and the impact of relation of borrower and lender on credit risk management. However, it is possible to concluded that although there have been a number of studies on credit risk management and related issues both in developed and developing countries, Ethiopia in particular, the association between Credit Risk management and profitability has not been examined in this manner before. 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.

Berhanu (2005) studied on the determinants of loan repayment performance of smallholder farmers in North Gondar, Ethiopia. In order to analyze the factors that affect loan repayment, he employed the two bit model. A total of 17 explanatory variables were considered in the econometric model. Out of these seven variables were found to significantly influence the repayment performance. These were land holding size of the family, agro-ecology of the area, total livestock holding, number of years of experience, number of contacts, sources of credit and income from off-farm activities. The remaining variables (family size, distance between main road and household residence, purpose of borrowing, loan amount and expenditure for social festivals) were found to have insignificant effect on loan repayment performance of smallholder farmers.

Abafita (2003) analyzed the microfinance repayment performance of Oromia credit and saving institution in Kuyu, Ethiopia. According to his finding; sex, loan size and number of dependents are negatively related to loan repayment. On the other hand age was found to be positive, while age squared turned to be negative. Income from activities financed by loan, repayment period suitability and loan supervision are positively and significantly related to loan repayment performance. Moreover, loan diversion is significant and negatively related to loan repayment rate. The negative sign implies that the use of diverted funds for non-income generating purposes. Abreham (2002) studied on the loan repayment and its determinants in small-scale enterprise financing in Ethiopia around Zeway area. He is found out other sources of income, education, and work experience related economic activities before the loan are enhancing loan repayment. While extended loan repayment period is influence the repayment performance negatively.

The literature reviewed indicates that the studies didn't analyze the challenges of credit risk effectively and properly especially the internal variables. Hence, it is difficult to concur that previous studies exhaustively examined the credit risk management practice of micro finance institutions especially in the context of Ethiopia. As a result, this study is designed to fill the aforementioned gaps (particularly in Addis credit and saving institution share company) having the main objective of Credit Risk management practice and its challenges by designing here under research questions.

1.3. Research Questions

1. What are the characteristics of credit risks that are most commonly faced in Addis Credit and saving institution
2. What techniques are used by the institution to manage the credit risk?
3. What are the challenges of credit risk management in Addis Credit and saving institution?

1.4. Objective of the Study

1.4.1. General Objective

The general objective of this study was to assess the challenges of credit risk management practice in Addis Credit & Savings institution and to determine the character of credit risk for the purpose of to find out the ways to manage that credit risk, with particular reference to borrowers in the selected 3 Addis credit and saving institution branch offices and address Addis credit and saving head office. .

1.4.2. Specific Objectives

- To identify the techniques that used to manage credit risk on Addis Credit and saving institution.
- To assess the characteristics of credit risk that implies the negative impact on the institute.
- To identify the challenge faced by the Addis Credit & Savings institution in credit risk management practice.

1.5. Scope and Limitation of the Study

Micro finance institutions have different branches. However, because of time, place, and cost constraint, the study is concerned on Addis credit and saving institution. In addition to this, the study focuses on their selected three branch office like Addis Ketema,Arada, Gulelebranches and head office.

In Ethiopia, there is lack of sufficient research conducted on the study. Thus, it is difficult to obtain adequate data from published articles; journals concerning the financial institution working in the country (Ethiopia). As result of this, the study only considers from employees point of view about microfinance institutions credit collection system. And due to the small/unique sample available for the study, results may not be generalization able beyond the specific population from which the sample would be drawn.

1.6. Significance of the Study

This study was make several contributions to both knowledge building and practice improvement in credit risk management. It is expected that it was aid to policy makers in their effort to revamp the sector. It shall also be of great relevance to the organizations under study as well as other financial institutions. The non -financial business firms, whether manufacturing or service oriented shall also benefit from the research findings. This is because the result of the study shall enable the users especially MFIs to appraise its credit policies and to review its operations critically for more result oriented approach in dealing with its credit facilities. Lastly, this study will contribute to the academic knowledge on how to implement effective strategy that mitigate credit risk effectively and it served as a stepping stone to future researchers by providing literature and also by aggravating them to conduct a research related to the subject matter as a further reference material.

1.7. Organization of the Study

This study had been arranged in five chapters. The first chapter consists of the introduction that includes: background of the study, statement of the problem associated with questions, objective of the study, significance of the study, scope of the study, limitation and organization of the study. The second chapter consisted of review of related theoretical and empirical literature review. The third chapter would be covered research design and methodology, Population and Sampling Design, Data Type and Sources, Method of Data Collection and Data Analysis. The fourth chapter covers the data analysis, interpretation and summary of the chapter. The last chapter would be consisted of Summary of the findings, conclusions, and recommendation.

CHAPTER TWO
REVIEW OF LITERATURE

2.1. Theoretical framework

The emergence of the global microfinance has a history of about three decades, yet has gone through stages of historical development. The microfinance industry is said to be in revolution; the service that was initiated in small scale and small village of South East Asia “Chintanga”. Bangladesh now turned to be international agenda and an issue addressing one of the main problems i.e. poverty in developing countries of the world (Arega, 2007). The term microfinance is of recent origin and is commonly used in addressing issues related to poverty alleviation financial support to micro entrepreneurs, gender development etc. There is however, no statutory definition of micro finance. The taskforce on supportive policy and Regulatory Framework for Microfinance has defined microfinance as “Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards”

Narrower definitions equate microfinance with microcredit, following early practice of NGO credit schemes. Microcredit is the provision of small loans to poor households and small business operators with or without guarantee (Degefe, 2009). In reality, poor people need access to so many more financial services than just micro-credit, including a range of micro savings and insurance products. Indeed, the first step for poor people on the path out of the poverty cycle is social and economic security. Appropriate savings and insurance, as well as loans for emergency expenditures or basic assets such as housing and education, can contribute significantly to such security, not least among poorer and more vulnerable households. These services can protect poor people from the impact of unforeseen crises and emergencies in their households or micro-business, from failing yet further into debt, and enable poor households to plan and manage their limited resources more effectively to meet their basic needs (Fisher and Sriram, 2002).

Gonzalez and Rosenberg, (2005) defined “Microfinance” as financial services for poor and low-income clients. In practice, the term is often used more narrowly, referring to services delivered by self-described “microfinance institutions” (MFIs) who usually use techniques developed over the last three decades to make and manage tiny uncollateralized loans. These techniques include group lending and liability, pre-loan savings requirements that test clients' willingness and ability to make regular payments, graduated loan sizes, and most importantly an implicit guarantee of quick access to future loans if present loans are repaid promptly. According to Robinson (2001), Microfinance refers to small-scale financial services – primarily credit and savings provided that to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban. Many such households have multiple sources of income.

2.1.1. Credit Risk

Beasens and Gestel(2009) defines credit risk as the risk that a borrower fails to pay and does not act according to their obligation to service debt. They state that the causes for the failure to pay could be incapability of the other party to pay or failure to pay on the due date. Besides they mentioned that by its character credit risk is the most apparent risk of a bank. In addition to this the writer characterize credit risk by ways of three aspect the first one is default risk is the possibility that payment is not issued at least within three month this delay will happen due to Counterparts with a weak financial situation, high debt burden, low and unstable income have a higher default probability, sector information and management quality. The second aspect is loss risk or loss given default (LGD) which is a fraction of exposure in the case of failure to pay and exposure risk is ambiguity on the accurate amount at risk at the very instant of a future default. In the same way, Singh (2013) stated that another term for credit risk is default risk and defines it as the bank's risk of loss arising from a counterparty that does not make payments in accordance with his/her promise. He also points out credit risk is the earliest and the main source of risk in the banking sector.

Credit risk encompasses both the possibility that a borrower will default by failing to repay principle and interest in timely manner, and the possibility that the credit quality of the obligor will deteriorate, leading to an economic loss (Ong, 2006). Credit risk occur when one of the counter parties to a transaction does not clear up in full either when the fund are outstanding or on some later date and it may result in bankruptcy of counterparty (Baker, 1998).According to Anuj(2011), credit risk is delay of one's own obligation in accordance with stetted contractual financial obligation within the deadline of payment by counter party. Credit risk is the possibility that debtors or borrowers incapability of paying its obligation in a way that predetermined contractual agreement made during credit approval process which adversely affect the working environment of the lender. Basel (2001) defined credit risk as a chance when borrowers fail to repay their loan partially or fully due to different circumstances. It also state that the extent to which the bank exposed to higher credit risk will lead to unexpected financial crises and lower credit risk will minimize the probability of the crises because large amount of profit will be generated from this department of the bank.

2.1.2. Common Types of Credit Risks in Microfinance Institutions

Financial intermediation involves some risks, with one major challenge facing financial institutions being to identify such risks and to hedge against them. The risks vary in type and intensity for different financial institutions, whether or not they operate in the same business environment. Each microfinance , therefore, has to identify its own unique set of risks and to manage it in its own way if it wishes to continue to sustain its operations.

According to Fernando (2008), risk management, in relation to an MFI is the process of controlling the likelihood and potential severity of an adverse event; it is about systematically identifying, measuring, limiting, and monitoring risks faced by an institution. Services are relatively small and simple when a new microfinance bank commences Operations. During the setting up of a new microfinance bank, it tends to be very aware of the financial risks that it faces, causing it to make a conscious effort to mitigate them. However, as microfinance bank grows in size and diversifies its loan portfolios, different types of risks, other than the obvious financial ones, tend to begin to manifest themselves Generally, the following three categories of risks that might face microfinance business have been identified.

2.1.2.1.Liquidity Risks

According to Craig and Dan (2011), liquidity risk arises when a microfinance is unable to meet its cash requirements or payment obligations timely and in a cost-efficient manner. Microfinance have to plan the volume of loans to be approved and disbursed, the withdrawal pattern of their saving clients (where MFI is allowed to mobilize deposits), and other fund requirements for operational purposes, and should be able to match available funds against such requirements.

According to Kolari, (2007) in order to reduce liquidity risk, each microfinance branch needs to prepare a daily fund plan that guides the matching of cash inflows from loan repayment and saving deposits (that usually take place in the afternoon) with cash outflows (from draw-downs, customer withdrawals and operational expenses) for the branch on a daily basis. Any positive balance or surplus fund should be deposited with a correspondent bank daily, while any anticipated shortfall should be covered by withdrawing cash from the bank early in the day. No overnight cash should be held by the branch, in order to eliminate the risk of fraud or theft. As in the case of the daily fund plan, each branch should also prepare a monthly fund plan that should outline the amount of loans to be granted, the volume of saving withdrawals from customers, and the anticipated operational expenses. The preparation of the plan assists the finance department to anticipate the funding requirements of the various branches, thereby allowing the determination in advance of any potential cash shortfall or surplus facing the branches concerned. The funds should then be moved to a position. where they can address the situation, while any arising idle funds are invested appropriately.

2.1.2.2.Credit Risk

Credit risk is defined as the probability that some of a MFI‘s assets, especially its loans, will decline in value and possibly become worthless. Because MFIs hold little owners‘ capital relative to the aggregate value of their assets, only a small percentage of total loans need to go bad to push a bank to the brink of failure. Thus, management of credit risk is very important and central to the health of a MFI and indeed the entire financial system. As MFI s makes loans, they need to make provisions for loan losses in their books. The higher this provision becomes, relative to the size of total loans, the riskier a bank becomes. An increase in the value of the provision for loan losses relative to total loans is an indication that the bank‘s assets are becoming more difficult to collect . Credit risk is the risk of a loss resulting from the debtor's failure to meet its obligations to the MFI in full when due under the terms agreed (Raghavan. 2003).

2.1.2.3.Operational Risk

Operational risks arise because of possible system or human errors in service or product delivery. Potentially, unexpected financial losses might occur as a result of a variety of issues, such as inadequate or deficient information systems, operational challenges, incompetent personnel, inadequate skill, deliberate breaches, or fraudulent tendencies. The management of such risks requires that the internal control framework is effective, the information technology (IT) used is adequate, the integrity of the employees is guaranteed, and the operating processes are streamlined. Given the various sources of operational risk, the most obvious is the interaction of loans and clients involving financial transactions. In the case of normal traditional banks, the staff undertaking credit assessment is usually well trained, with multiple levels of crosschecking put in place. Unfortunately, in the case of MFIs, there are usually numerous short-term loans of small amounts, making elaborate crosschecking not cost - effective. As a result, the possibility of both error of assessment and deliberate fraud is relatively high (Mersland and Strom, 2007)

2.1.3. Credit Risk Exposure

The credit risk exposure (CR) is measured by the sum of the level of loans past due 30 days or more and still accruing interest namely Portfolio at Risk (PAR-30). In robustness tests it is included further measures of credit risk by estimating various econometric specifications for three additional different explanatory variables; the write-off ratio (WOR) which is the value of loans written off during the year as uncollectible, as a percentage of average gross loan portfolio over the year. An additional measure of credit risk is the Risk Coverage Ratio (RC) which is measured as the Adjusted Impairment Loss Allowance/PAR>30 Days and finally Loan Loss Reserve Ratio (LLR). This is measured as the ratio of loan loss reserves to gross loans or simply put as Loan loss reserve/Value of loans outstanding. It is an indicator of how much of the gross loan portfolio has been provided for but not charged off(Amoah B., 2005).

2.1.3.1.Loan product Design

MFIs can mitigate a significant portion of default risk by designing loan products that meet client needs. Loan product features include the loan size, interest rate and fees, repayment schedule, collateral requirements and any other special terms Loan products should be designed to address the specific purpose for which the loan is intended(Binfoh*et. al*., 2005)

2.1.3.2.Credit Committees

Establishing a committee of persons to make decisions regarding loans is an essential control in reducing credit (and fraud) risk. If an individual has the power to decide who will receive loans, which loans will be written off or rescheduled, and the conditions of the loans, this power can easily be abused and covered up (Amoah-Binfoh, 2005) while loan officers can serve on the credit committee, at least one other individual with greater authority should also be involved. The credit committee has the responsibility not only for approving loans, but also for monitoring their progress and, should borrowers have repayment problems, getting involved in delinquency management (Amoah-Binfoh, 2005).

2.2.Causes of Credit Risk in MFI

According to Macaver and O, Ehimare (undated), the source of credit risk can be either from borrower level or from financial (lender) level.

2.2.1. Causes of Credit Risk at Borrower Level

The causes of loan default at the borrowers' level includes:-

- Failure of investment to generate sufficient income due to improper technical advice, inadequate support services, marketing risks or natural disasters.
- Diversion of loan from desired objective operations to non-essential consumption which makes it difficult to meet repayment commitment on time.
- Existence of liabilities towards informal lenders, which may get precedence over institutional lenders, leading to delinquency and default.
- Contingenciess at the borrower household, such as sickness, accident or death (pure risk).

- Operation at very low level of subsistence, forcing additional income generated through loan-supported activities to be appropriated for basic needs.
- Prevalence of low real rate of interest or pegging of interest rate far below the market rate.
- Absence of incentives for prompt repayment, or penalties for delayed repayment

2.2.2. Causes of Credit Risk at Financial Institution (Lender) Level

At the financial institution level, loan default may be due to any or a combination of the following:-

- Defective procedures for loan appraisal, which could lead to financing of bad projects, thereby giving rise to delinquencies and defaults.
- Quality of loan officers their mobility in the field, and their capacity to judge borrowers as well as the incentive package available to them affect repayment. When loan officers are assessed more based on compliance with lending targets than with recovery performance, it could lead to bad loans. When responsibility for lending and recovery are vested with separate officials in a credit agency, recovery tends to decline.
- Untimely loan disbursement and inappropriate repayment schedules. In addition, when the procedure for repayment is bulky, borrowers tend to default.
- Inability or reluctance of lenders to enforce sanctions against conspicuous defaulters.
- When institutions have limited contact with borrowers, default tends to increase. But when borrowers are in frequent contact and use several services of lenders, default reduces.
- Absence of sound accounting and management information system

2.3.Credit Risk Management

According to Singh (2013) credit risk management includes all management function such as identification, measurement, monitoring and control of the credit risk exposure. The writer further indicated that for long term achievement of banking sector effective credit risk management practice is a vital issue in the current business environment and poor credit risk management policy will create serious source of crisis in the banking industry.

According to Atakelt (2015) credit risk management practice define as the process of analyzing and renewing Credit risk management documents and apply constantly in actual Credit granting process, Credit administration and monitoring and risk controlling process with suitable Credit risk environment, understanding and identification of risk so as to minimize the unfavorable effect of risk taking activities and the effectiveness of credit risk management process is dependent on different variables such as proper application of best Risk management documents, Staff quality, Credit culture, devoted top management bodies, sufficient training program, proper organizational structure, ample level of internal Control and Performance of intermediation function. This indicates that credit risk management includes different issues such as developing and implementing suitable credit risk strategy, policy and procedure, accurate identifications of risk, best credit granting process, credit administration, monitoring and reporting process determining and controlling the frequency and methods of reviewing credit policy and procedure and setting authority and responsibility clearly. Besides he mentioned that by establishing suitable credit risk environment, acceptable level of credit limit, best credit granting process, proper monitoring and controlling credit risk and optimizing risk return of a bank credit risk management develop credit performance.

Cebenoyan & Strahan (2004) examine empirically how active management of credit risk using loan deal affects capital structure, lending, profits, and risk of banks. They find that banks which are Active in the loan sales market hold less capital and make more risky loans than other banks. They conclude that advances in credit risk management improve credit accessibility rather Than decrease risk in the banking system. The management of credit risk has become a key objective for all financial institutions across the world. The goal of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters (Basel, (1999).

According to Anuj (2011) through designing and implementing a Credit Risk Framework, Performing a Credit Risk Assessment, Building Credit Risk Scoring Models and Credit Risk Reporting control panel and Forecasting Loan Loss we can construct effective credit risk management and he also believe that most effective credit risk management focuses on processes, culture, people and organization because we are working with them. "Credit risk management includes both preventive and curative measure. Preventive measure comprise risk assessment , risk measurement , and risk pricing , early warning system to pick signal of future default in advance and undertake better credit portfolio diversification. The curative measure aim at minimizing post sanction loan losses through steps such as securitization, derivative trade, risk sharing and legal enforcement" (Jain, 2014, p3).

2.4. Conceptual Framework

The conceptual framework (Ahmed & Malik, 2015) below literature how different variables interact and are inter related; Such as Client Appraisals, Credit risk controls, credit collection policies and Credit Risk factors. Client appraisals help MFIs to improve loan performance, as they get to know their customers. The use of 5Cs used in client appraisal is character, Capacity, collateral, capital and condition.

Character: A measure of the reputation of the firm, its willingness to repay, and its repayment history e.g. age factor.

Capital: The equity contribution of owners and its ratio to debt (leverage). These are viewed as good predictors of bankruptcy probability. High leverage suggests a greater probability of bankruptcy.

Capacity: The ability to repay, which reflects the volatility of the borrower's earnings. **Collateral:** In the event of default, a banker has claims on the collateral pledged by the borrower. The greater the priority of this claim and the greater the market value of the underlying collateral, the lower the exposure risk of the loan.

Cycle (or Economic) Conditions: The state of the business cycle; an important element in determining credit risk exposure, especially for cycle dependent industries.

2.4.1. Credit Collection Technique

According to Christoph (2002) the effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Knowing how to encourage customers to pay their outstanding debts to financial institutions like banks on time can increase the cash flow of MFI. Therefore a number of collection techniques are employed. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As the loan account becomes past due or overdue the collection effort becomes more personal and strict. The basic techniques are:

Telephone Calls: If the loan client passes the due date, a telephone call may be made to the customer to request immediate repayment and up to date his or her account.

Personal visits: If the telephone call made is not resulted positive response vesting his business and discussing the issue with the customer can be a very effective collection procedure.

Letters: If the efforts made so far is unsuccessful and not resulted positive response a polite letter is to be served reminding the customer of its obligation followed by warning letters for the action to be taken in future and its consequence. Collection letters are the first step in the collection process for past due and overdue loan accounts.

Using Collection Agencies Firms can turn uncollectible accounts over to a collection agency or an attorney for collection. The fees for this service are typically quite high; the firm may receive less than fifty percent on accounts collected in this way.

Legal Action: legal action is the most stringent step in the collection process. It is an alternative to the use of a collection agency not only is direct legal action expensive, but is may force the debtor in to bankruptcy, thereby reducing the possibility of future business without guarantying the ultimate receipt of overdue amount.

2.5.Credit Analysis

Credit analysis is the primary method in reducing the credit risk on a loan request. This includes determining the financial strength of the borrowers, estimating the probability of default and reducing the risk of non-repayment to an acceptable level. In general, credit evaluations are based on the loan officer's subjective assessment (or judgmental assessment technique).Once a customer requests a loan, bank officers analyze all available information to determine whether the loan meets the bank’s risk-return objectives. Credit analysis is essentially default risk analysis, in which a loan officer attempts to evaluate a borrower’s ability and willingness to repay. Similarly Compton (1985) identified three distinct areas of commercial risk analysis related to the following questions:

1. What risks are inherent in the operations of the business?

2. What have managers done or failed to do in mitigating those risks?

3. How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a list of factors that indicate what could harm a borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower. Is management aware of the important risks, and has it responded? As Tomothy (1995 cited in Lawrence, 1997), the last question forces the analyst to specify how risks can be controlled so the bank can structure to an acceptable loan agreement. A MFI's credit analysts often use the five C's of credit to focus their analysis on the key Dimensions of an applicant's credit worthiness identified five C's of credit. This includes Character, Capacity, Capital, Collateral, and Conditions.

1. Character: The applicant's record of meeting past obligations, financial, contractual, and moral. Past payment history as well as any pending or resolved legal judgments against the applicant would be used to evaluate its character.

2. Capacity: The applicant's ability to repay the requested credit. Financial statement analysis, with particular emphasis on liquidity and debt ratios, is typically used to assess the applicant's capacity.

3. **Capital**: The financial strength of the applicant as reflected by its ownership position. Analysis of the applicant's debt relative to equity and its profitability ratios are frequently used to assess its capital.

4. **Collateral**: The amount of assets the applicant has available for use in securing the credit. The larger the amount of available assets, the greater the chance that a firm will recover its funds if the applicant defaults A review of the applicant's balance sheet, asset value appraisals, and any legal claims filed against the applicant's assets can be used to evaluate its collateral.

5. **Conditions**: The current economic and business climate as well as any unique circumstances affecting either party to the credit transaction. For example, if the firm has excess inventory of the items the applicant wishes to purchase on credit, the firm may be willing to sell on more favorable terms or to less creditworthy applicants. Analysis of the general economic and business conditions, as well as special circumstances that may affect the applicant or firm is performed to assess conditions.

2.6.Connection between Credit risk Management Systems and Loan Performance

- **Credit Terms**

These identify the situation under which savings and loans institutions will advance credit to a customer, which basically stipulate the credit period and the interest attached. Credit period give a definite period within which the credit is will be granted. Mostly such period is prejudiced by security value, Credit risk, in addition to the account and market competition (Ross, Westfield& Jordan, 2008). The interest rate being a cost on the lend fund which affect the performance of the loan

- **Credit Risk Control**

This is a control measure pipeline to avoid a loan default which could arise from non- payment of loan from a borrower, where the lender loses its principal and interest. This is mitigated through the use of risk based pricing, covenants, acclaim insurance, tightening and diversification (Ross et al, 2008).

- **Credit Collection Policy**

Due to the diverse characteristics nature in loan payment of customers who could be either a slow payer or non-payers as most will not pay their bills in time, therefore in such approach there should be accelerating approach to eliminate bad debt losses (Kariuki, 2010).

2.7.Credit Risk Mitigation

Dohnal (2008) defined Credit Risk Mitigation (CRM) as a mechanism used by different credit institution in order to minimize their credit risk related with exposure which the institution continuous to hold. He also further point to that credit risk mitigation techniques can be distinguish in to two parts the first one is funded credit protection which includes real estate and financial instrument. The reduction of the credit risk exposure is draw from the right of the credit institution in case of default to liquidate or retain, to obtain transfer or appropriation of certain assets, to retain certain assets, to reduce the amount of the exposure and to replace the amount of the exposure. The other one is unfunded credit protection which includes guarantee. The reduction of the credit risk exposure of a credit institution derives from the responsibility of a third party to pay an amount in the occasion of borrowers incapability to pay their loan or on the incidence unexpected events.

2.7.1. Credit Risk Mitigation techniques

A bank should disclose the effect of credit risk mitigation techniques, including collateral, guarantees, credit insurance and legally enforceable netting agreements (Basel, 2000)

i. Funded credit protection

a. Collateral

Collateral is an asset that serves as security against counter party risk. Anderson and Joeveer (2014). A collateralized transaction is a transaction where the credit exposure or potential credit exposure of the credit institution to a counterparty is hedged in whole or in part by collateral posted by the counterparty or by a third party on behalf of the counterparty (Basel (2004). Collateralized credit exposures must have a risk biased exposure amount less than the same credit exposure without credit protection. The collateral can be in the form of real estate, receivable and other form of physical collateral (Dohnal, 2008).

b**. On-balance sheet netting**

According to Basel (2004) Banks where legally enforceable netting arrangement for loans and deposits they may calculate capital requirement on the bases of net credit exposure. The claim between the credit institution and counter party may be recognized. They also indicated that Master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions.

ii. Unfunded credit protection

The amount that the safety provider has carried out to pay in the event of the default or non-payment of the borrower or on the event of other specified credit situation is the value of unfunded credit protection. where the amount that the protection provider has carry out to pay is not higher than the exposure value, the value of the credit protection shall be reduced by 40%; where the amount that the protection provider has carry out to pay is higher than the exposure value, the value of the credit protection shall be no higher than 60% of the exposure value (Basel, 2004).

a. Guarantees

A guarantee must represent a direct claim on the guarantor with the extent of the cover being clearly defined and unquestionable. A guarantee must be irrevocable; there must be no clause in the guarantee that would allow the guarantor to cancel unilaterally the cover of the guarantee or that would increase the effective cost of cover as a result of deteriorating credit quality in the guaranteed exposure. A guarantee must also be unconditional; there should be no clause in the guarantee outside the direct control that could prevent the guarantor from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the due payment. The indirect guarantee covers all credit risk elements of the claim; both the original guarantee and the indirect guarantee meet all the operational requirements for guarantees except that the indirect guarantee need not be direct and explicit to the original claim (Basel, 2008)

b. **Loan Commitments**

A loan commitment is a facility which gives the obligor the option to borrow at his own discretion. In practice, this essentially means both a loan (equal to the amount currently drawn on the line) and an option to increase the amount of the loan up to the face amount of the facility. The counterparty pays interest on the drawn amount, and a fee on the undrawn amount in return for the option to draw down further. For these exposures three factors influence the revaluation in future rating states: the amount currently drawn; expected changes in the amount drawn that are due to credit rating changes; and the spreads and fees needed to revalue both the drawn and undrawn portions. All of these factors may be affected by covenants specific to a particular commitment (Morgan, 1997)

2.7.2. Tools of Credit Risk Management

According to Sunitha and Raju (2013), Thirupathi& Kumar (2013),Bhaskar (2014) and Nayan & Kumaraswamy (2014) the tools through which credit risk management is carried out are:

a) Exposure Ceilings: Prudential Limit is linked to Capital Funds - say 15% for individual borrower entity, 40% for a group with additional 10% for infrastructure projects undertaken by the group, Threshold limit is fixed at a level lower than Prudential Exposure; Substantial Exposure, which is the sum total of the exposures beyond threshold limit should not exceed 600% to 800% of the Capital Funds of the bank (i.e. six to eight times).

b)Review/Renewal: Multi-tier Credit Approving Authority, constitution wise delegation of powers, Higher delegated powers for better-rated customers; discriminatory time schedule for review/renewal, Hurdle rates and Bench marks for fresh exposures and periodicity for renewal based on risk rating, etc are formulated.

c) Risk Rating Model: Set up comprehensive risk scoring system on a six to nine point scale. Clearly define rating thresholds and review the ratings periodically preferably at half yearly intervals. Rating migration is to be mapped to estimate the expected loss

d) Risk based scientific pricing: Link loan pricing to expected loss. High-risk category borrowers are to be priced high. Build historical data on default losses. Allocate capital to absorb the unexpected loss.

e) Portfolio Management: The need for credit portfolio management emanates from the necessity to optimize the benefits associated with diversification and to reduce thepotential adverse impact of concentration of exposures to a particular borrower, sector or industry. Stipulate quantitative ceiling on aggregate exposure on specific rating categories, distribution of borrowers in various industry, business group and conduct rapid portfolio reviews.

f) Loan Review Mechanism: This should be done independent of credit operations. It is also referred as Credit Audit covering review of sanction process, compliance status, and review of risk rating, pickup of warning signals and recommendation of corrective action with the objective of improving credit quality. It should target all loans above certain cut-off limit ensuring that at least 30% to 40% of the portfolio is subjected to LRM in a year so as to ensure that all major credit risks embedded in the balance sheet have been tracked.

2.8.Empirical literature

Nagarajan (2001) in his study of risk management for microfinance institutions in Mozambique found that risk management is a dynamic process that could ideally be developed during normal times and tested at the wake of risk. It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that it is possible to minimize risks related losses through diligent management of portfolio and cash-flow, by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders.

Achou and Tenguh (2008) also conducted research on "bank performance and credit risk management" found that there is a significant relationship between financial institutions performance (in terms of profitability) and credit risk management (in terms of loan performance). Better credit risk management results in better performance. Thus, it is of crucial importance that financial institutions practice prudent credit risk management and safeguarding the assets of the institutions and protect the investors interests. This is also true for micro finance institutions. Method used by the researchers is mixed research method. Matu (2008) carried out a study on sustainability and profitability of microfinance institutions and noted that efficiency and effectiveness were the main challenges facing Kenya on service delivery.

Ho and Yusoff (2009), in their study on credit risk management strategies of selected financial institutions in Malaysia the majority of financial institutions and banks losses stem from outright default due to inability of customers to meet obligations in relation to lending, trading, settlement and other financial transactions. Credit risk emanates from a bank dealing with individuals, corporate, financial institutions or sovereign entities. A bad portfolio may attract liquidity as well as credit risk. The aim of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable boundary The efficient management of credit risk is a vital part of the overall risk management system and is crucial to each banks bottom and eventually the survival of all banking establishments. It is therefore important that credit decisions are made by sound analyses of risks involved to avoid harms to banks profitability. They held effective management of credit risk is an essential component of a comprehensive technique to risk management and critical to the long-term success of all banking institutions.

Sindani (2012) in her study Credit risk controls adopted by microfinance institutions have an effect on loan performance, credit insurance, signing of covenants with customers, diversification of loans, credit rating of customers, reports on financial conditions, refrain from further borrowing had an effect on loan performance. Collection policies adopted by microfinance institution had an effect on loan performance, stringent policy had a great impact on loan performance, and the lenient policy had an effect but was not as great as that of stringent policy.

Berhanu (2005) studied on the determinants of loan repayment performance of smallholder farmers in North Gondar, Ethiopia. In order to analyze the factors that affect loan repayment, he employed the two bit model. A total of 17 explanatory variables were considered in the econometric model. Out of these seven variables were found to significantly influence the repayment performance. These were land holding size of the family, agro-ecology of the area, total livestock holding, number of years of experience, number of contacts, sources of credit and income from off-farm activities. The remaining variables (family size, distance between main road and household residence, purpose of borrowing, loan amount and expenditure for social festivals) were found to have insignificant effect on loan repayment performance of smallholder farmers.

Abafita (2003) analyzed the microfinance repayment performance of Oromia credit and saving institution in Kuyu, Ethiopia. According to his finding; sex, loan size and number of dependents are negatively related to loan repayment. On the other hand age was found to be positive, while age squared turned to be negative. Income from activities financed by loan, repayment period suitability and loan supervision are positively and significantly related to loan repayment performance. Moreover, loan diversion is significant and negatively related to loan repayment rate. The negative sign implies that the use of diverted funds for non-income generating purposes. Abreham (2002) studied on the loan repayment and its determinants in small-scale enterprise financing in Ethiopia around Zeway area. He is found out other sources of income, education, and work experience related economic activities before the loan are enhancing loan repayment. While extended loan repayment period is influence the repayment performance negatively.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter had been discussed the research method that applies in carrying out the study. It covers the following areas; Research design, target population, sampling design, data type and source, Data collection Method and data analysis.

3.1.Research Design and Approach

Bhattacherjee (2012) defined a research design is a comprehensive plan for data collection in an empirical research project. It has also indicated the two categories of data collection techniques used in scientific research, quantitative and qualitative design. According to Orodho (2008), descriptive research design as a method of collecting information by interviewing or administering a questionnaire to a sample of individuals. Descriptive research, on the other hand, aims to present a complete description of a subject within its context. This study mainly used descriptive research design because the researcher is interested in describing the existing situation under this study. And also, it describes the current status of credit risk management practice and its challenges. Further, a mixed research approach adopted was adopted to achieve the objectives of the study. In-depth interviews, document review and questionnaire survey were the data collection techniques used in the study that combine both qualitative and quantitative methods.

3.2.Population and Sampling Design

Currently, Addis credit and saving institution is operating in 10 different districts in Addis Ababa. From the total service delivery posts, using purposive sampling techniques the researcher selected three branches, namely Arada, Addis Ketema, and Gulele sub city. In addition, head office staffs were considered (see Table 3.1).

Table 3.1 Population determination for the study

List of sample branch	Branch Mangers	Operation managers	Loan, credit, and risk officer	Total population
Arada	1	1	21	23
Addis Ketema	1	1	22	24
Gullele	1	1	24	26
Head Office	2	2	3	7
Total				80

According to Hussey (1997) no survey can ever be deemed to be free from error or provide 100% surety and error limits of less than 5% and confidence levels of higher than 95% can be regarded as acceptable. Bearing this in mind at a confidence level of 95%, the margin of error will be 0.05 or 5%. To obtain the minimum population sample for this study, the researcher adopted judgmental sampling as a technique using Yamane's formula (cited in Israel, 1992) as follows:

$$n = \frac{N}{1 + N * (e)2}$$

Description: n= is the sample size, N = is the population size, e = is the margin of error.

$$n = \frac{80}{1+80*(0.05)^2}$$

$$n = \underline{\underline{67}}$$

Based on sound judgment, from those selected branch office the total respondents would have been selected 30 number of loan officers, 10number of operation managers, 20 credit analyst officer, 13numbers of credit risk analyst and 7 management staff

Table3.2. Sample Size Determination

S.N	Respondents	Population Size	Selected sample size	Data collection tools
1	Loan officer	30	25	Questionnaire
2	Credit Analyst	20	17	Questionnaire
3	Credit risk analyst officer	13	11	Questionnaire
4	Operating manager	10	8	Questionnaire
5	Management Staff	7	6	Interview
Total sample selection		80	67	

3.3.Data Type and Sources

Both primary and secondary data was applied for this study. The primary data were collect from the above listed of credit performers through structured questionnaires and interviews. The secondary data was used for supporting the study and to get the findings of other researchers in the area.

3.4.Method of Data Collection

Primary data were gathered through both questionnaire and interview. The questionnaire includes both close-ended and open-ended questions, and distributed to sample respondents involving branch managers, operation managers, credit officers working on loan processing and credit risk analyst are targeted for the data collection where all the issues on the questionnaire is properly addressed. The closed ended questions was used to test the rating of various attributes and this helped in reducing the number of related responses in order to obtain more varied responses. The open-ended questions provided additional information that may not have been captured in the close-ended questions. Semi structured interview refers to the use of already prepared questions during the study. Interview schedule was held based on the pre-defined schedule. Before proceeding to any interview session the interviewees have been made to get additional information on the purpose of the session as well as confidentiality matters. The interview sessions held with 3 branch managers of Addis Ketama, Arada, Gulele branches and 3 head office credit management staffs and the analysis of the interview was made based on the information obtained from these branch managers.

3.5.Data Analysis Method

According to Saunders *et al.* (2000), analysis is the ability to break down data and to clarify the nature of the component parts and the relationship between them. The researcher analyzed and interpreted the data by linking them to the theory, problem, purpose and research questions and the researcher made sure that there is coherence throughout the entire thesis. Descriptive statistics were used to analyze the data, and results are presented using tables. Open-ended qualitative responses were analyzed through data reduction and subsequently creating themes based on the trends, and results are presents together with survey results.

3.6.Validity and Reliability Test of the Study

Saunders et al (2009) describe validity and reliability as referring to how collection of thedata or how the conduction of the analysis will bring reliable findings. The researcher believes that data collection method and the findings are in line with what was intended to measure. To a large extent subject or participant error, subject or participant bias, observer error and observer bias were minimized. The reliability of the questionnaire is also statistically calculated by using Cronbach's Alpha. Regarding to this, the reliability and validity test has been conducted for the entire questionnaire items and it was found to be greater than 0.6 or (60%).Furthermore, the analysis of the collected data, the researcher ethically use only for this research project with integrity. The findings of the research were presented without any deviation from the outcome of the research. In addition, the researcher gave full acknowledgements to all the reference materials used in the study.

3.7.Ethical Considerations

Obeying ethical rules is vital in conducting research. The researcher received a letter of introduction form the St. Mary's university. Letter of permission enabled the researcher to carry out the research and approach the informants. Participant of the study was informed about the objectives of the study emphasizing that the data were used only for the intended academic purpose only. Careful attention was given, regarding respecting the rights, needs and values of the study subjects, and maintaining confidentiality of the data and acknowledging sources of information.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

This chapter covers the presentation and analysis of the data used in the study. It shows the findings of the study which seek to answer the research questions in relation to the study objectives. The data were gathered from Addis Credit and saving institution through questionnaire. The analysis was done in relation to the two main sources of data used for this study, that is primary and secondary data sources. Descriptive statistics were used to analyze the data. Furthermore, descriptions were made based on the results of the tables.

4.1. Survey Response Rate

The researcher distributed 67 structured questionnaires to sampled employees of Addis Credit and saving institute. And 6 of them were interviewed. Though concerning the questionnaires, out of 61 respondents to whom the questionnaires were distributed purposely sampled to Addis Credit and Saving institute staff's especially direct credit performers, 58(95%) of them were successfully completed and returned and 3(5%) of them are not collected. This response rate was satisfactory to make conclusions for the study.

4.1.1. Profile of the Respondents

This study is reliable since the respondent was selected based on their duty and responsibility and their past experience on credit management and appraisal, credit analyst expert, credit administrator those directly attached to micro finance activities and their answer was expected to be reliable. Moreover, this analysis takes into consideration not only finding from the primary data but also secondary data have been also gathered and interpreted. It was conducted on voluntary bases and the researcher tries to respect the participant right and privacy. The finding of the research was presented without any variation from the outcome of the research. In addition, the research was full acknowledgment to all reference material used in the study. The participants on survey questionnaire have different personal information; besides these differences they introduce different responses towards on the challenges of Credit Risk Management practice in Addis Credit and saving microfinance institute. Thus, in this research process the demographic characteristics of the respondents like gender, age, educational level and work experience were assessed and shown in table 4.1 as follows;

Table 4.1 Respondents' profile

Variables	Classification of variables	Frequency(N)	Percentage
Sex	Male	38	66%
	Female	20	34%
	Total	58	100%
Age	25-35	18	31.03%
	36 – 45	24	41.37%
	46-55	16	27.58%
	Total	58	100%
Education level	Diploma	30	51.72%
	Bachelor Degree	25	43.10%
	Master's Degree	3	5.17%
	Total	58	100%
Work experience	Less than 5 years	10	17.24%
	Between 6 to 15 years	28	48.27%
	Between 16 to 31 years	13	22.41%
	above 32 years	7	12.06%
	Total	58	100%

Source: Own Survey, 2018

As it was shown on the above table (4.1), the highest percentage of participants in this study was males who form 38(66%) of the respondents and the rest 20(34%) were females. The study sought to determine the gender which the MFIs had been in existence in the organization. In the case of classification of respondents, the highest percentage of participant's age category were between (36-45years) who form 24(41.37%) of the total respondents and the second highest percentage of respondents age category were between (25-35 years) it accounts 18(31.03%). With respect to the educational qualification of sample respondents, the result revealed that 51.72% of the respondents were having College Diploma. On the other hand, 43.10% of the respondents were degree holders. This indicates that most of the MFIs had been in educational levels are diploma holders.

In addition, as presented on the above table (4.1), the study sought to establish the length of time which the Addis Credit and saving micro finance employer had been in existence in the organization, from the findings 28(48.27%) of the respondents indicated 6 to 15years work experience and 13(22.41) % of the respondents indicated 16 to 31 years work experience in the institute. The remaining 17.24% of the respondents indicated less than 5 years whereas 12.06% of the respondents indicated for more than 32 years' work experience. This result implies that most of the Addis Credit and saving institute employees had been in existence between 5-10 years. In addition, this indicated their long period of experience and that contribute to both the reliability and validity of the information they offer.

4.1.2. Assessment of Credit Risk management and it Challenges

In this section frequency distribution and the percentage of the respondent's responses to their questionnaire based on their expectations and perceptions were being estimated in accordance with five dimensions of Likert rating scale. It was also indicated that survey results regarding to direct related issues of credit risk management practice and its challenges in the Addis Credit and saving institute. This was aimed at understanding the institute's credit risk exposure in terms of the default problem and how this can be situated in the context of the current study. Findings obtained from this analysis are depicted on the table below.

Table 4.2 Adoption of Credit risk Management Practices

Response	Frequency	Percentage
Yes	48	83%
No	10	17%
Total	58	100%

Source: Own Survey, 2018

The study required to determine the organizations that had adopted Credit risk Management practices. From the above table 4.2, findings 83% of the respondents indicated that their organizations had adopted Credit risk Management practices; whereas 17% indicated that their organizations had not. This implies that a significant number of organizations had adopted the use of Credit Management practices is a factor of credit risk management.

Table 4.3Extent to which Addis MFI use client appraisal in Credit risk Management

Number of clients	Frequency	Percentage
Very great extent	10	17.24%
Great extent	15	25.86%
Moderate extent	33	56.89%
Total	58	100

Source: Own Survey, 2018

The above table 4.3 determine the extent to which MFIs used client appraisal in Credit risk Management practice, from the findings 18.6% of the respondents indicated to a very great extent, 25.86% of the respondents indicated to a great extent whereas the remaining 56.89% of the respondents indicated that a moderate extent their client appraisal processed for analyzing credit risk. This implies that most of ADCSI used client appraisal in Credit risk Management to a great extent.

Table 4.4: Level of agreement on client appraisal in ADCSI

Factors	**Strongly Agree N (%)**	**Agree N (%)**	**Neutral N (%**	**Disagree N (%)**	**Strongly Disagree N (%)**
Client appraisal is a viable strategy for credit management.	18(31.03)	34(58.6)	2(3.44)	4(6.89)	0
the MFI have competent personnel for carrying out client	20(34.48)	28(48.3)	0	6(10.34)	4(6.89)
Client appraisal considers the character of the customers seeking credit facilities	10(17.7)	25(43.1)	4(6.89)	12(20.7)	7(12.06)
Aspects of collateral are considered while appraising clients.	7(12.06)	12(20.68)	4(6.89)	25(43.1)	10(17.7)
Failure to assess customers capacity to repay results in loan defaults	22(37.93)	30(51.7)	0	6(10.3)	0

Source: SPSS Output from Survey Data, 2018

As indicated on the above table 4.4 (item 1), lack of client credit appraisal affect micro finance institute credit financing process. Regarding to this, 89.63 % of the respondents were agreed that

Client appraisal is a viable strategy for credit management practices and ADCSI apply client appraisal performance evaluation process for disbursing loan. Accordingly, overall the great majority of the respondents agreed on the importance of the items listed as far as clear appraisal is fully concerned by the institute. With regard to the MFI have competent personnel for carrying out client as shown in the above table 4.4 (item 2), majority 82.78% of the respondents were agreed that Addis credit and saving MFI have competent personnel for carrying out client. The remaining, 17.22% of the respondents were disagreed that the institute cannot competent personnel for carrying out client. Based on this result, the researcher understood that the importance of competent personnel as a key to carry out clients appraisal.

As shown the above table 4.4 (item 3), client appraisal considers the character of the customers seeking is an important factor for credit facilities and analyzing credit risk assessment practice. And it implies, 60.8% of the respondents were agreed that the institute considered client appraisal characters of its customer for credit facilitates. But, the remaining 32.76% of the respondents were disagreed that the institute cannot considered client appraisal of its customer for facilitating credit. The rest 6.89% of the respondents neither agree nor disagree of them. Based on this statement, Tomothy (1995:665) quoted that "Character is an applicant's record of meeting past obligations, financial, contractual, and moral. It indicated past payment history as well as any pending or resolved legal judgments against the applicant would be used to evaluate its character. As per this result, the researcher would understand that client appraisal characters were an important issue for facilitating customer's credit order.

In addition to the above table 4.4 (item 4), question forwarded to respondents to their opinion about "Aspects of collateral are considered while appraising clients". Regarding to this, 60.8% of the respondents were disagree with this statement and the remaining 32.72% of the respondents were agreed that aspect of collateral was considered during client appraisal process. Based on Basel (2004) noted, A collateralized transaction is a transaction where the credit exposure or potential credit exposure of the credit institution to a counterparty is hedged in whole or in part by collateral posted by the counterparty or by a third party on behalf of the counterparty. And the collateral can be in the form of real estate, receivable and other form of physical collateral. So that Addis credit and saving institute wisely utilized collateral policies for minimizing credit risk exposure. As shown the above table 4.4 the last items, majority 89.63% of the respondents were agreed that "Failure to assess customer's capacity to repay results in loan defaults" and 10.6% responded that disagree by this statement that was absence of failure to assess customer's capacity to repay loan default. In general, from this result the researcher implicit that there was a challenge during assessing credit risk management practice and client appraisal factor was significant impact on credit risk analyzing process.

4.1.2.1.Credit Risk Controls

Table 4.5: Level of agreement on credit risk control

Factors	Strongly Agree N (%)	Agree N (%)	Neutral N (%	Disagree N (%)	Strongly Disagre
Imposing loan size limits is a viable strategy in credit management	22 (37.93)	32 (55.17)	2 (3.44)	2 (3.44)	-
The use of credit checks on regular basis enhances credit management.	23 (39.65)	33 (56.89)	-	2 (3.44)	
Flexible repayment periods improve loan repayment	26 (44.83)	30 (51.72)	2 (3.44)	-	-
Penalty for late payment enhances customers commitment to loan Repayment	20 (34.48)	27 (46.55)	3 (5.17)	5 (8.62)	3 (5.17)
The use of customer credit application forms improves monitoring and credit management as well	25 (43.10)	31 (53.44)	2 (3.44)	-	-
Credit committees involvement in making decisions regarding loans are essential in reducing default/credit risk	20 (34.48)	27 (46.55)	2 (3.44)	5 (8.62)	4 (6.89)

Source: SPSS Output from Survey Data, 2018

As can be seen from table 4.5 item 1 to 5 respondents were asked to indicate their level of agreement on the imposing loan size limits is a viable strategy in credit management. Accordingly, the majority 55(93.10%) of the respondents were agreed on the importance of the items listed as far as credit risk control is concerned during credit analysis process. Specifically, the result showed their agreements on the methods to use credit risk control in Credit risk Management and the fact that Imposing loan size limits is a viable strategy in credit risk management. Still item 2, shows that 96.54 % of the respondents agreed on the importance of credit checks on regular basis enhances credit risk management as a keyto carryout credit risk control.

Ross, Westfield & Jordan, (2008) pointed out, risk control measure pipeline to avoid a loan default which could arise from non- payment of loan from a borrower, where the lender loses its principal and interest. This is mitigated through the use of risk based pricing, covenants, acclaim insurance, tightening and diversification. Based on this noted and the respondents result the institute considered risk control mechanism as basic tool for enhancing credit risk management practice and measure credit default/problem/.

As indicated on the above table 4.5 (item 3), flexible repayment periods improve loan repayment and one factor for credit risk controls. Regarding to this, 96.55% of the respondents were agreed and replied that flexible repayment periods improve loan repayment as akey for consideration in credit risk control. Regarding, penalty for late payment enhances customers commitment to loan repayment during credit risk control process. In this regard, majority 81.03% of the respondents were agreed that Addis credit and saving institute considered penalty for late payment for enhancing customers commitment to loan repayment. In addition, 97% of the respondents responded and agreed that the use of customer credit application forms improves monitoring and credit management as well and the institute uses this application.

As shown the above table 4.5 items5, majority 81% of the respondents were agreed that credit committee's involvement in making decisions regarding loans are essential in reducing default/credit risk. The remaining 15.51% of the respondents were disagree that credit committee's involvement in making decisions regarding to loan is not as such important for reducing loan default/ credit risk.

Amoah-Binfoh, (2005) suggested that a credit committee is make a decisions regarding loans is an essential control in reducing credit (and fraud) risk. The credit committee also has the responsibility not only for approving loans, but also for monitoring their progress and should borrowers have repayment problems, getting involved in delinquency management. Therefore, the institute evaluates and monitors credit risk through forming credit committee for the reasons of improving loan default and credit risk as well. Generally the overall respondents agreed up on the key importance of considering Credit risk Management is risk control methods.

4.1.2.2.Credit Collection Policy

Table 4.6: Credit collection policy in Credit risk Management

Factors	**Strongly Agree N (%)**	**Agree N (%)**	**Neutral N (%**	**Disagree N (%)**	**Strongly Disagre**
Inadequate available credit collection policies have assisted towards effective credit risk management.	15 (25.86)	35 (60.34)	3 (5.17)	5 (8.62)	-
Formulation of collection policies have been a challenge in credit management.	22 (37.93)	26 (44.83)	4 (6.89)	4 (6.89)	2 (3.44)
Enforcement of guarantee policies provides chances for loan recovery in case of loan default	15 (25.86)	37 (63.79)	-	6 (10.34)	-
Staff incentives are effective in improving recovery of delinquent loans.	12 (20.68)	25 (43.10)	8 (13.79)	10 (17.24)	3 (5.17)
A stringent policy is more effective in debt recovery than a lenient policy	14 (24.13)	28 (48.27)	7 (12.06)	9 (15.51)	-

Source: SPSS Output from Survey Data, 2018

The study required to establish the level of agreement on the above table 4.8 items 1 relating to inadequate availability of credit collection policies have assisted towards effective credit management practices of MFI. From the finding majority, 50(86%) of the respondents were agreed that in ADCSI credit collection policies were not enough for improving effective credit risk management.

Accordingly, Kariuki, 2010) pointed out, the diverse characteristics nature in loan payment of customers who could be either a slow payer or non-payers as most will not pay their bills in time, therefore in such approach there should be accelerating approach to eliminate bad debt losses. This result indicated that the institute should follow strict credit collection policies for improving loan repayment, credit risk management challenges and credit default.

Regarding to the above table 4.6 (item 2), most 82.76% of the respondents were agreed on the formulation of collection policies has been a challenge in credit management process. Whereas 10.33 % of them were disagreed that formulation of credit collection policies couldn't a challenge for credit risk management. The rest 6.89% of them were neither agree nor disagree on this statement.

And also item 3 shows that, 89.65 % of the respondents were agreed that the enforcement of guarantee policies provides chances for loan recovery in case of loan default. Based on this responded result Basel,(2008) argued that guarantee must also be unconditional; there should be no clause in the guarantee outside the direct control that could prevent the guarantor from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the due payment. Therefore, the institute must utilize guarantee policy as a tool for reducing loan default and credit fraud.

Additionally, item 4, Staff incentives are effective in improving recovery of delinquent loans. This is a key indicator on collection policy of MFI. As per this statement, more than 50% of respondents were agreed them. Generally speaking from the respondents finding agreed that well organized staff incentive policy is a key factor for managing credit risk and decreasing credit default.

As shown in the last item, stringent policy than a lenient policy have assisted MFIs collection policy towards effective credit risk management. And, 72.40% of the respondents were agreed and replied that stringent policy is more effective in debt recovery than a lenient policy for improving effective credit risk management system in ADCSI. Therefore, the researcher generalized the above analysis, absence of credit collection policy is one challenge and significantly impact on assessing credit risk management practices, loan repayment problem and credit experts give misleading information to the approving authority on the ability to repay the loan and preparing poor credit risk analysis.

4.1.2.3.Credit Risk Factor

Table 4.7: Credit Risk factor assessment

Factors	**Strongly Agree N (%)**	**Agree N (%)**	**Neutral N (%**	**Disagree N (%)**	**Strongly D**
Addis Credit and Saving institute has Poor credit risk mitigation Strategies for improving the challenges of loan disbursement	18 (31)	29 (50)	5 (8.62)	6 (10.34)	-
low frequency and depth of training given to analyze credit risk processing	16 (27.58)	28 (48.27)	2 (3.44)	7 (12.06)	5 (8.62)
The Capacity of front line credit performers are low	20(34.48)	22(39.9)	4(6.89)	8(13.8)	4(6.89)2
unexpected financial losses might occur as a result of operational risk or inadequate skill	22 (39.9)	28 (48.27)	5 (8.62)	3 (5.17)	-
The institute Credit Risk Management practice is weak	18 (31.03)	26 (44.83)	-	10 (17.24)	4 (6.89)
In credit analysis process a loan officer attempts to evaluate a borrower's ability and willingness to repayment is poor	15 (25.86)	25 (43.10)	6 (10.34)	8 (13.73)	4 (6.89)

Source: SPSS Output from Survey Data, 2018

As shown the above table 4.7 (item 1), respondents were asked concerning the degree of their agreement on "Addis Credit and Saving institute has Poor credit risk mitigation Strategies for improving the challenges of loan disbursement". The result indicated that 81% of the respondents were agreed that Poor credit risk mitigation Strategies were applied by ADCSI for improving the challenges of loan disbursement. Dohnal (2008) infer, credit Risk Mitigation (CRM) is a mechanism used by different credit institution in order to minimize their credit risk related with exposure which the institution continuous to hold. Therefore, the institute should considered risk mitigation strategies as a tool through the entire credit risk management practices.

From above table 4.7 item 2 shows that 44(75.85%) of the respondents were agreed that the institution's frequency and depth of training given to analyze credit risk processing time is low and It does not encourage training program in the area of credit risk while, 12(21%) of the respondents were disagree. In the same table Item 3 depict that 42(74.38%) of the respondents reply and agreed that the institutions front line credit performers were low and execute management regularly reviews the credit performance capacity through training for effectively analyzing credit risk as well.

As shown the above table 4.7 (Item 4) tell us that 50(88.17%) of the respondents were agreed that the unexpected financial losses might occur as a result of operational risk or inadequate skill while, 3(5.17%) of the respondents were disagreed by this statement. As per Mersland and Strom, (2007) viewed, the unexpected financial losses might occur as a result of a variety of issues, such as inadequate or deficient information systems, operational challenges, incompetent personnel, inadequate skill, deliberate breaches, or fraudulent tendencies. Therefore the institution should more emphasizes on rectifying the operational risk and inadequate skill of the staff's by recruitments of highly qualified peoples in the area of credit risk

Item 5 in the above table 4.7, also shows that 75.86% of the great majority responded agreed that the institute Credit Risk Management practice is weak, while 24.13% of the respondents were disagreed that the institute credit risk management practice is enough to evaluate credit risk and also the credit analysis process of a loan officer attempts to evaluate a borrower's ability and willingness to repayment is poor. Based on this statement, more than 50% of the respondents were agreed them. According to Singh (2013), credit risk management practice includes all management function such as identification, measurement, monitoring and control of the credit risk exposure. Therefore, the institute should follow credit risk management practice for minimizing credit risk exposure. In addition, the study indicates that the institutions were encourage the training program in the area of credit risks, and the execute management regularly reviews the organization credit performers capacity. Nevertheless, the institutions not much focus on recruitments of highly qualified peoples in the area of credit risk analyst.

4.1.3. Challenge of credit risk management

The major problem facing the borrowers in repaying the principal and interest, and types of challenges faced by the borrowers were presented below:

Table 4.8.Challenges Related on Loan Repayment

No	Item	Frequency of responses	
		No	%
1	Does an institution ask the collateral for loan?		
	Yes	55	94.83
	No	3	5.17
	Total	58	100
2	Types of collateral asked by the institutions:		
	Building	10	17.24
	Car	0	0
	Home materials	16	27.58
	Animals	2	3.44
	Lending by group as collaterals	30	51.72
	Total	58	100
3	Do you face challenge for repayment of the loan?		
	Yes	48	82.76
	No	10	17.24
	Total	58	100
4	Types of challenges happened on borrowers:		
	Natural factor	10	17.24
	Political factor	-	-
	Economic factors	16	27.58
	Market conditions	7	12.06
	Repayment period is not suitable	25	43.10
	Total	58	100
5	Does the execute management regularly reviews the organizations loan performance in managing credit risk?		
	Yes	18	31.04
	No	40	68.96
	Total	58	100

Source: survey questionnaires 2018

Table 4.8 item 1 show that 55(94.83%) of the respondents were accept the institutions ask the collaterals during loans disbursement. In Item 2 depict types of collaterals asked by the institutions. Based on this question 30(51.72%), 16(27.58%) and 10(17.24%) of the respondents were replied that the institute Lending by group as collaterals, home materials and building respectively asked borrowers as a collateral for loan repayment. Item 3 tell us that 48(82.76%) of the borrowers collaterals asked by the institutions matches its asset value while the remaining is not match with its asset value.

Item 4 depicts types of challenge happened by the borrowers during repayment period. Among those 10(17.24%) and 16(27.58%) of the borrowers challenged by natural factors and economic factors respectively, 25(43.10%) and 7(12.06%) of the borrowers challenged that repayment period is not suitable and market conditions respectively. The last item in the above table the majority 40(68.96%) of the respondents reply that the institution executes management regularly reviews the organization performance in managing its business risk. As per this presented data result, the study indicates that the institutions were encourage the program in the area of credit risks, and the execute management regularly reviews the organization performance.

4.1.4. Results of Interview

According to Christoph, (2002) the effective credit collection techniques are one of the necessities for financial institutions in any economic climate. Under normal circumstances loan clients are expected to pay in cash or deposit or keep their installment repayment as per the agreement made. As per this statement the researcher was tried to ask the question on the type of basic credit collection techniques. Based on this, 40% of the respondents were replied that the institute applied Legal action is the most stringent step in the credit collection process. Whereas, 30% of the respondents were confirmed that letter is one of the techniques for credit collection. The remaining, 20% and 10% of the respondents were replied that the institute applied personal visit and telephone calls respectively were the strategies for credit collection techniques. Therefore, this result indicated that legal action is an important credit collection technique that Addis MFI was applied.

The following section summarized and presented the result of interview sessions with 6 Branch managers and head office staff administrator. Since the responses of the participants of the interview session was more or less alike, the researcher has preferred to summarize and present the result of the session in one set.

Model or technique to manage credit risk responding to this question the interviewees have come up with various factors that affect loan repayment. Among the factors raised are; Give training to the staff, designed or implemented clear credit policy, use different measurement technique like PAR, Arrears rate and write off policy etc.

- **Reason of NPLs ratio were increasing**

Responding to this question the respondents said that there are different reasons were happened in the case micro finance of NPL were increasing poor screening of borrowers, weak appraisal of loans, lack of immediate follow up, corruption at field staff level such as taking bribe for loans or frauds that can result in delinquencies and demotivated employees due to salary.

Do you think the current credit procedures; reviewing and approval culture is helping the MFI to achieve its objectives?

When answering to this question, the respondents said yes , it has not a doubt that poor analysis of the borrowers' project feasibility contributes its effect to the loan repayment. Because the borrowers invested the loan on this project, so that if this project is not profitable the borrowers will fail his business and the loan repayment of the ADCSI. So to achieve the goal of ADCSI the primary messages procedures like recruitment/selection/ of the customers and approval of the business.

- **Reasons for violating covenants of loan by customers**

Responding to this question the respondents said in the case of group loan problems are happened between the members of the group regarding to duties and responsibly in their workplace, unexpected happening is occurred in the business from internally or externally. Some comment or suggestions regarding the credit risk management system of the MFI.

Regarding to this question the respondents said, that establishing an Appropriate Credit Risk management. The board of directors should have responsibility for approving periodically (at least annually). Operating under a Sound Credit Granting Process the institution must operate within sound and well-defined credit granting criteria, Maintaining an Appropriate Credit Administration, Measurement and Monitoring Process.

The study identified a number of challenges confronting the bank in their use of collateral. This section presents and analyses these challenges as reported.

Challenges in the Use of Collateral

Findings revealed that the bank faces four key challenges in their use of collateral in the credit granting process. One of the challenges may be due to the fact that there might be other claimants to the same properties used by the customer as collateral. Again, the collateral in question could be a subject of other existing litigation (inter or intra families). Further, there is the potential of destruction to the property in question, as well as the location of the property. Although, these were identified as challenges, the most significant challenge as depicted by the table is the potential for destruction, which recorded the highest response compared to the other challenges identified.

According to the response of interviewee of the three institutions branch managers the following are major problem that most micro finance faces i.e. major cause of credit risk. The institutions believed that these problems have negative impact on credit risk management.

The institution also faces problem of lack skilled human power that facilitate the day-to-day activities of the institutions. Borrowers lack awareness and takes loans, which is not planned and used for the intended purpose, which result to capital wastage of the institution and incur unnecessary collection cost.

- ✓ Market failure for the products of borrowers.
- ✓ Lack of sufficient source of loanable fund in the side of institutions.
- ✓ Employee turnover.
- ✓ Level of salary assigned to the credit risk management department.
- ✓ Natural factors such as draught, climate conditions etc.
- ✓ Using manual system to process the loan and loan approval system especially in case of Addis credit and saving Share Company.
- ✓ Borrowers do not return principal and interest on time.

- ✓ Failure to post daily transaction to the ledger and carelessness of employees of the institutions that use manual system.

Generally, from the response of the interviewee we can understand that the major problem of microfinance institutions in relation to credit risk is emanated from institutions, some of them are from the clients or borrowers and, the other is from natural factors.

CHAPTER FIVE

SUMMARY, CONCLUSTIONS AND RECOMMENDATION

This chapter summarizes the various research results which emerged from the study. The results obtained were pegged with the respective objectives set out in chapter one of the dissertation. Conclusions are drawn and necessary recommendations are made based on the research findings.

5.1.SUMMARY OF FINDINGS

This section discussed the findings of the statistical analysis data that was gathered from the respondents and it would be presented in a summarized and informative manner. Based on the interpreted data, major findings were carried out;

- Aspects of collateral does not considered while appraising clients, failure to assess customer's capacity to repay results in loan defaults, client appraisal considers the character of the customers seeking credit facilities and that Addis Credit and saving institute have competent personnel for carrying out client appraisal.
- The study established that Addis Credit and saving institute use credit risk control in Credit Management to a great extent. The study further established that interest rates charged affects performance of loans in the Addis Credit and saving institute, Credit committees involvement in making decisions regarding to loans are essential in reducing default/credit risk, the use of credit checks on regular basis enhances credit management, Penalty for late payment enhances customers commitment to loan repayment, the use of customer credit application forms improves monitoring and credit management, flexible repayment periods improve loan repayment and finally that the use of credit checks on regular basis enhances credit management.
- The study revealed that Addis Credit and saving institute use collection policy in Credit risk Management to a great extent. Formulation of collection policies have been a challenge in credit management , enforcement of guarantee policies provides chances for loan recovery in case of loan defaults, Staff incentives are effective in improving recovery of delinquent loans, a stringent policy is more effective in debt recovery than a lenient policy, regular reviews have been done on collection policies to improve state of credit management, and finally that available collection policies have assisted towards effective credit management.

- Though, as per credit risk factor, the researcher was carried out such finding from data analysis result; More than 50% of the respondents were agreed that Addis Credit and Saving institute has Poor credit risk mitigation Strategies for improving the challenges of loan disbursement, 74.38% of the respondents reply and agreed that the institutions front line credit performer's capacity were low and depth of training given to analyze credit risk processing and in credit analysis process a loan officer attempts to evaluate a borrower's ability and willingness to repayment is poor. In addition, unexpected financial losses might occur as a result of operational risk or inadequate skill that affect the organization credit management practice
- Whereas, Majority of the borrowers faced the challenges of loan repayment. Among the challenges the economic conditions and unsuitable repayment period was the critical one. And also, the execute management does not regularly reviews the organizations loan performance in managing its credit risk
- Regarding the major factors which contributes for the increase in the level of NPLs in the microfinance institutions, respondents strongly claimed that absence of proper group formation, employees lack of motivation and commitment, poor screening of borrowers, weak appraisal of loans, lack of immediate follow up, corruption at field staff level such as taking bribe for loans or frauds result in delinquencies.
- The Challenges of Addis Credit and saving institute to reduce credit risks are proper client screening, designed clear policy and also strong follow up of customers especially after loan disbursed and also follow some ways to check up the level of credit risk like PAR, arrears rate, loan loss provision

Challenges in the Use of the Collateral

The study found that the bank faces four key challenges in their use of collateral in the credit granting process. One of the challenges may be due to the fact that there might be other claimants to the same properties used by the customer as collateral. Again, the collateral in question could be a subject of other existing litigation (inter or intra families). Further, there is the potential of destruction to the property in question, as well as the location of the property.

Challenges of Credit Risk Management

It was found that the bank's management of credit risk is confronted by a number of challenges identified to include: the credit complexity, monitoring and reporting as well as managing the credit origination of process. Analysis of the various RII however reveals that the strongest risks are associated with the issue of monitoring and reporting.

5.2.CONCLUSIONS

From the findings, the study found that , credit risk control and collection policy had effect on credit management of Addis Credit and saving institute. The study established that there was strong relationship between credit risk management of AdCSI and client appraisal, credit risk control and collection policy.

The study revealed that a unit increase in client appraisal is one character of credit risk that faced on the institute and it would lead to increase in credit risk management of AdCSI; this is an indication that there was positive association between client appraisal and credit risk management of the institute.

An increase in credit risk control would lead to increase in credit risk management of Addis MFI , which shows that there was positive relationship between credit risk management of Addis MFI and credit risk control and a unit increase in collection policy would lead to increase in credit risk management ,this is an indication that there was a positive relationship between credit risk management of Addis MFI and collection policy. Client appraisal, credit risk control and collection policy significantly influence credit risk management of Addis MFI negatively .

Credit risk management is the way that micro finance institutions seeks to minimize the exposure of their losses emanating from loan delinquencies and defaults. Credit risk management methods are loss control, loss financing and internal risk reduction. The overall objective is maximization of business value to shareholders by minimizing the cost of risk.

The institutions are effective in follow up and supervising the borrowers, in identifying the repayments history of borrowers, in encouraging the training program in the area of credit risk, in designed credit administration and loan documentation procedures, in setting appropriate plan and procedures to manage credit risk, in designing detailed and formalized credit evaluation process, and in implementing sound principle to identify measure, monitor and control credit risk.

On the other hand the institutions complicated/difficulties with due to lack of giving training to the borrowers, due to lack effective recruitments of highly qualified peoples, due to lack of advice on collaterals to borrowers, challenges of borrowers for repayments of the loan, due to lack of computerized system for recording and posting of daily transaction, due to lack of experienced periodic examination of collaterals, due to lack of sufficient loan able fund, due to employee turnover.

Despite of this, the institutions can use group guarantees and collaterals (most often house and other movable properties like vehicles, cows, goat, sheep's), business plan and leased land. However, the institute used Legal action; Letter and personal visit were effective credit collection techniques.

5.3.RECOMMENDATIONS

The study recommends that Addis MFI should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery.

- The study recommends that there is a need for Addis MFI to enhance their client appraisal techniques so as to improve their financial performance. Through client appraisal techniques, the institution will be able to know credit worth clients and reduce their non-performing loans.
- There is also need for Addis MFI to enhance their credit risk control this will help in decreasing default levels as well as their non-performing loans.
- Improve the collateral registration process and obtain cash equivalent collateral for each loan made to the customers.
- The institution should work more on creating of awareness to their clients about the purpose of loans and the way to do business using the loan amount since those awareness make the client to use loan effectively and help the institutions to minimize credit risk

- The institute to strengthen the credit process unit by recruiting qualified and credit risk analyst specialists to support the customers properly and address the credit request with knowledgeable performer.
- It is better to control employee turnover by providing enough salary since enough salary reduce employee turnover.
- Addis credit and saving share company it is better to develop computerized system of recording and posting the transaction since computerized system is quickly record and post daily transaction and quick loan processing time
- Developing and maintaining credit approval authority structure and granting credit approval authority to qualified and experienced individuals.

5.4.Future Research

The study sought to assess credit risk management of microfinance institutions in the case of ADCSI. Further research should also be done on the relationship between credit risk management and nonperforming loans on Microfinance Institutions in Ethiopia and on the reasons for loan default in microfinance organizations from the clients‟ perspective.

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APPENDIX

SAINT MARY`S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

DEPARTMENT OF PROJECT MANAGEMENT

INSTRUCTIONS

Thank you for taking time to complete this questionnaire. Kindly answer the following questions. The responses will be used for academic purposes only, and will be treated with utmost confidence.

Research Topic: - assessing the challenges of credit risk management practice in Addis Credit and saving institution.

Dear Respondents:-I would like to express my earnest appreciation for your generous time, honest and prompt responses.

Objective: This questionnaire is designed to collect data about the challenges of credit collection in microfinance institutions. The information that you offer me with this questionnaire will be used as a primary data in my research which I am conducting as a partial fulfillment of the requirements for the degree of Masters of Business Administration in project management (MBA) at St. Mary's University. Therefore, I need your help and would appreciate your sparing time to complete the attached questionnaire. All answers will be kept strictly confidential and only aggregate results will be reported. And I want to assure you that this research is only for academic purpose.

Thank you again!!!

Section I: General Information

- You are not required to write your name.
- Please put a tick mark (√) in the corresponding boxes to indicate your perception**.**

Section II: - Background Information

1. Sex: Male [ ] Female [ ]
2. What is your Age?

25-35 years [ ] 36-45 years [ ]

46- 55years [ ] 56 years and above [ ]

3. How money years you have worked in the institution?

Less than 5 years [ ] between 16 to 31 years[ ]

Between 6 to 15 years[ ] above 32 years [ ]

4. Educational level: High school graduate [ ] Technical school graduate [ ]

College Diploma [ ] BA/BSc Degree [ ]

Master's Degree [ ] PhD [ ] TVET [ ]

5. Has your organization adopted Credit risk Management practices? Yes [ ] No [ ]
6. To what extent does the MFI use client appraisal in Credit Management?

   Very great extent [ ] Great extent [ ]

   Moderate extent [ ] Low extent [ ]

   Not at all [ ]

   Section III: The following section aims to know the confidence level as well as validation on the assessing the challenges of credit risk management practice in Addis Credit and saving institution, which threaten the decision making as subjective judgments. With respect to your own feeling about the particular organization for which you are now working place, indicate the degree of your response with each statement by putting a tick mark (√) on one of the five alternatives. The responses are measured on 5- point scales with the following verbal anchors: Strongly Agree (5), Agree (4), Neutral (3), Disagree (2) and strongly Disagree (1)

Items descriptions	Levels of Agreement				
	5	**4**	**3**	**2**	**1**
	Strongly agree	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
7. CLIENT APPRAISAL					
1.1. Client appraisal is a viable strategy for credit management.					
1.2. The MFI has competent personnel for carrying out client					
1.3. Client appraisal considers the character of the customers seeking credit facilities.					
1.4. Aspects of collateral are considered while appraising clients.					
1.5. Failure to assess customers capacity to repay results in loan defaults					
2. CREDIT RISK CONTROL					
2.1. Imposing loan size limits is a viable strategy in credit management					
2.2. The use of credit checks on regular basis enhances credit management.					
2.3. Flexible repayment periods improve loan repayment					
2.4. Penalty for late payment enhances customers commitment to loan Repayment					
2.5. The use of customer credit application forms improves monitoring and credit management as well					

2.6.Credit committees involvement in making decisions regarding loans are essential in reducing default/credit risk					
2.7.Interest rates charged affect performance of loans in the MFI					
3. CREDIT COLLECTION POLICY					
3.1. Inadequate available collection policies have assisted towards effective credit management.					
3.2.Formulation of collection policies have been a challenge in credit management.					
3.3.Enforcement of guarantee policies provides chances for loan recovery in case of loan default					
3.4.Staff incentives are effective in improving recovery of delinquent loans.					
3.5.Regular reviews have been done on collection policies to improve state of credit management.					
3.6.A stringent policy is more effective in debt recovery than a lenient policy					
4. **CREDIT RISK FACTOR**					
4.1.Addis Credit and Saving institute has Poor credit risk Mitigation Strategies for improving the challenges of loan disbursement					
4.2.low frequency and depth of training given to analyze credit risk processing					
4.3. The Capacity of front line credit performers are low					

4.4. Addis Credit and Saving institute should disclose the effect of credit risk mitigation techniques					
4.5. unexpected financial losses might occur as a result of inadequate or operational risk or inadequate skill					
4.6.The institute Credit Risk Management practice is weak					
4.7. In credit analysis process a loan officer attempts to evaluate a borrower's ability and willingness to repay is poor					

Section IVGeneral Question

1. What type of credit collection techniques that the institute was applied?

Telephone CallsPersonal visits

LettersLegal Action

2. What challenges do you face in the use of collateral in the credit granting process composition of loan?

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3. What information do you need when making a lending decision to know whether to grant credit to a customer or not? ---
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For interview

1. What are the major problem affect the performance of institutions on credit risk management?
2. If the trend of NPLS ratio was increasing, what might be the reason (s)?
3. Do you think the current credit procedures; reviewing and approval culture is helping the MFI to achieve its objectives?

Thank you for your time