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Assessment of Credit Management practices of MFIs in Ethiopia: (The Case of Addis Credit & saving institution)

By: TILAHUN GEMECHU

December, 2018

Addis Ababa

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Approved By Board of Examiners

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LIST OF ABBREVIATIONS AND ACRONYMS

ADCSIAddis	Credit & Savings Institution
AEMFI	Association of Ethiopian Micro Finance Institution
BOG	Bank of Ghana
CR	Credit Deposit
DBE	Development Bank of Ethiopia
FGD	Focal Group Discussion
GB	Grameen Bank
LENDERS	Finance Institution likes Banks & Micro Finance Institution
MFIs	Micro Finance Institution
NBE	National Bank of Ethiopia
SHGs	Self Help Groups
SMEPol	Small & Medium Enterprise Development Project
TVT	Technical and Vocational Training

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ABSTRACT

This research examines the credit management practices of microfinance institutions in Ethiopia the case of Addis credit and saving institution (AdCSI) which is engaged in development activities in Addis Ababa city administration. This study was conducted with the objective of assessing the practices of the credit management of MFIs in the case of AdCSI. The institution is selected purposively with regard to its capacity, service years and areas of interventions. In order to achieve this objective, primarily data were collected from 76 employees, 96 customers and 9 officials using semi-structured questionnaires and interviews. Moreover, two focal group discussions with 24 participants from customers were conducted to cross check the result obtained using different methodology. Furthermore, secondary data were obtained from the records of AdCSI and loan ledger. In this study, the researcher prefers to focus on the major component of credit management used by many MFIs in developing countries. These are: credit policy and procedure; credit appraisal processes; credit administration and documentation; and credit follow-up, supervision and monitoring. These major components of credit management are chosen to assess the credit management of the institution. The finding of the study has revealed that the selected MFI has major weaknesses in managing their credit based on the above chosen factors/components. Among the major weaknesses assessed by the researcher are include Lack of proper collection of credit information; the standard and eligibility criteria are mainly affiliated by the government policy; making credit decision without maintaining the standard and criteria based on the credit policy; in ability to properly identify their borrowers like their work address, activities, profitability etc; being difficult to provide technical support on the job; absence of well-established credit administration system like computerized credit administration systems and document record, HR and facilities; absence of early notification systems regarding deadlines, interest due, penalties etc; and no proper, regular and effective the follow up and supervision systems. One major recommendation that was made for management to put in place follow up the implementation credit policies and standards that conform to regulatory requirements and the institution's over all objectives and improve the miss implementation of the ADCSI credit management policies or procedure. Cope up to the changes of credit management policies with the regulatory body or organ. Furthermore, the institution needs to allocate sufficient and skilled staff and adequate facilities.

Key words: Microfinance, Credit management, Credit Policy, Credit Monitoring and supervision.

CHAPTER ONE

INTRODUCTION

1.1. Background of the study

Credit management is a comprehensive process made up of the monitoring of loan facilities, extension of credit, distinguishing the market segments as well as delineating the returns generated (Asante, 2015). The policy on credit management comprises systems, guidelines and principles that serve as a blueprint for employees in the credit department in awarding loans and steering the total collection of credit facilities (Asante, 2015). The policy on credit management is described as a combination of principles devised to reduce expenditure connected with loan delivery while taking full advantage of the gains that can be generated from them (McNaughton, 1996). Formulating and implementing loan policies is the most important responsibilities of microfinance's directors and management. In this activity, the Board of Directors take the services and co-operation of the microfinance's credit officers, who are well experienced and expert in the techniques of lending and are also familiar with external and internal factors that affect to the lending activities of the bank. One critical prerequisite for being able to supervise credit delivery effectively is the capacity to astutely and competently administer the lines of credit to clients. To be able to reduce the vulnerabilities associated with uncollectable loans, companies must exercise a better understanding of economic capacity of clients, history of customers‟ credit rating and varying repayment arrangements. According to (Sante, 2015) in order to make an intrusion into new markets as well as enroll more clients depends on the competence to rapidly and effortlessly make well-informed credit decisions and set appropriate lines of credit.

It is obvious that the primary functionality of a financial institution is the provision of loan facilities to deserving clients located in their sphere of jurisdiction (Asante, 2015). Banks are in business with the sole aim of making profits and so, they seek to generate profits through giving out loans and investment in other assets. Against this backdrop, loan supply and delivery are part of the core business activities of financial institutions because without giving credit in the form of loans and advances to individuals and firms, their main objective for being in business would be difficult. It will be a challenge to enact the most favorable credit policy as the best amalgamation of the variables of credit policy is quite arduous to acquire. An institution might decide to manipulate some of the variables within a period and observe the effect. It should be noted that the firm's loan guide is greatly influenced by economic conditions (Pandey, 2008). The firm's loan guide has direct relationship with economic condition. The guidelines of the firm on credit management may experience a shift as the prevailing conditions of the economy also metamorphose (Asante, 2015). The success of lending out credit depends on the methodology applied to evaluate and to award the credit (Ditcher, 2003) and therefore the credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower. The concept of credit management became widely appreciated by Microfinance Institutions (MFI's) in the late 90s, but again this did not stop loan defaults to this date (Modurch, 1999).

According to Sindani (2012) a key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. The ability to penetrate new markets and customers hinges on the ability to quickly and easily make well-informed credit decisions and set appropriate lines of credit. As him credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected (Sindani, 2012). It may be difficult to establish an optimal credit policy as the best combination of the variables of credit policy is quite difficult to obtain. A firm will change one or two variables at a time and observe the effect. It should be noted that the firm's credit policy is greatly influenced by economic conditions (Pandey, 2008). The firm's credit policy has direct relationship with economic condition. As economic conditions change, the credit policy of the firm may also change.

Microfinance Institutions and other finance institutions must develop a credit policy to govern their credit management operations (Pandey, 2008) and since microfinance institutions generate their revenue from credit extended to low income individuals in the form of interest charged on the funds granted (National Bank of Ethiopia Annual Report, 2010) the disbursed loan difficult to determine its collection. The success of lending out credit depends on the methodology applied to evaluate and to award the credit (Ditcher, 2003) and therefore the credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower.

Micro Finance institution was first started in 1980's by professor Mohammed Yenus in Bangladesh. He led the way with pilot group lending scheme for the landless people. Finally this becomes a Grameen Bank which is now used as a model for many countries in the world.
According to proclamation (No. 40/1996) of the Federal Government of Ethiopia, Microfinance business means an activity of extending credit, in cash or in kind, to peasant, farmers or urban small entrepreneurs, of loan size of what shall be fixed by the National Bank. When we back to our Mother Land Ethiopia Government appreciate and support micro finance Institutions at their start-up stage. The country's five years action plan starting from the year 1992 E.C has included Micro Finance services as one component part of agricultural extension package, to facilitate poverty alleviation and rural development in the country. As a result government issued a proclamation (No. 40/1996) and a number of directives for licensing and supervising these institutions.
Moreover, those microfinance institutions have been established since 1994/95 through government licensing under the supervision of National Bank of Ethiopia (NBE) with proclamation #40/1996 (Zerai & Rani, 2012 as cited in Tolosa, 2014). Since its establishment the numbers of MFIs were sixteen. Although the microfinance industry were started their financial services most lately, the industry has shown the remarkable growth in terms of clients outreaches and provision of diversified financial products for the needy societies at large (Wolday, 2000). The number has been extensively increased at an increasing rate to 35 microfinance institutions (Garomsa , 2017 and NBE, 2016). More than 80% of this micro finance institution in the country has been operating in the rural areas where access to formal financial institution was nearly impossible.

Currently there are many licensed Micro finance institutions in Ethiopia working in both rural and urban areas. So research focused on Addis credit and saving institution which is established in January 2000 G.C. Addis credit and saving institution gives credit and saving services for all types of businesses, individuals and social welfares like "edir". It creates job opportunity for thousands of unemployed persons and contributes its part in reduction of unemployment rate and poverty. As LedgerWood (1999) which is a micro-finance hand book, cited that, credit is borrowed funds with specified terms for repayment .When there is no sufficient accumulated savings to finance a business and when the return on borrowed funds exceeds the interest rate charges on the loan, that makes sense to borrow rather than not doing the business activity until sufficient savings can be accumulated, assuming the capacity to service the debt exists.

As Ledgerwood (1999) explains that loans are generally made for productive purposes that is, to generate revenue within a business. Some micro-finance institutions give loans for consumption housing or special occasions. So in order to use the credit properly there should be appropriate credit management, control system & continuous follow up procedure. According to Ledgerwood, methods of credit delivery in the micro–enterprise lending program generally can be divided into two broad categories. These are individual & group based lending approaches based on the program delivers & guarantees its loans. Among the above two credit delivery methods group based lending is assumed to be a better credit management system for micro-enterprises lending program.

According to Warue (2012) Microfinance institutions regulators, credit referencing bureau and MFIs policymakers have to be wary about increasing loan delinquency in the industry and put in place appropriate management strategies to mitigate portfolio at risks. In addition MFIs management should regularly review credit risk techniques used and expand loan monitoring framework among Self Help Group (SHGs) for effective credit portfolio assessment. Further SHGs management should strengthen group solidarity to facilitate prompt loan repayment by the group members.

1.2. Statement of the problem

The primary objective of microfinance institutions (MFIs) is to provide finance services (credit and saving) to the poor in order to release financial constraints and to help alleviate poverty. Availability of credit management in MFIs could act as a catalyst for rapid development in their area of jurisdiction. From the trend of developed countries in addition to banking services micro-finance institutions play a great role to fight poverty as a means of building financial system that serves the society especially the poor. Relying on the above facts, micro finance institutions have many merits even if their development is restricted due to various problems (Shekhar, 1985). That means social, political, economic, level of education etc.

The Microfinance Information Exchange (MIX) reports that African regional deposits made-up 54% of the MFIs gross loan portfolio. In contrast, voluntary savings represented merely 22% of the Ethiopian microfinance portfolios (AEMFI, 2010). It is believed that MFIs in Ethiopia are characterized by low savings, high default rates, poor loan/credit management and very low saving mobilization, etc (Alemayehu,2014). In case of AdCSI, mobilizing voluntary saving is only 10% of their gross loan portfolio (Reta, 2011). Therefore, the microfinance sector in Ethiopia still depends on donated funds and has not been in a position to finance its future business by generating income operation (NBE, 2010).

Similarly, most of recent studies on MFIs in Addis Ababa, in general and AdCSI, in particular had produced similar foundations and were mainly focus on assessing the loan repayment determinants (Pasha and Negese, 2014; Reta, 2011) and credit risks management in MFI (Suganda, 2017 and Belay, 2013). Credit management practices influence identification of potential credit default which is critical as high default rates lead to decreased cash flows, lower liquidity levels, financial distress and lower loan provision rates (Muturi, 2016). In contrast, lower credit exposure means an optimal debtors' level with reduced chances of bad debts and high profitability (Gitman, 1997). Scheufler (2002) indicated that credits policies, standards and appraisal procedures enable the firm to earn financial returns. Credit management provides a leading indicator of the quality of deposit MFIs credit portfolio. Since effective credit management is essential to the long-term success of any microfinance institution as they generate most of their income from interest earned on loans extended to small and medium entrepreneurs (Mbucho, 2015). However, this is not adequately assessed credit management practice of these microfinance institutions. Hence, this study has focused on assessment of credit management practice of MFIs in Ethiopia the case of Addis Credit and Saving Institution (AdCSI).

1.3. Basic Research Questions

In order to achieve the main objectives of the study four research questions were developed.

- Does the credit policy and procedure strictly implemented by the institution at all levels?
- Does the institution properly undertake credit application evaluation and the credit appraisal process to effectively analyze the credit worthiness of the customers?
- Does the institution have effective credit administration and documentation practice?
- How the follow up and supportive supervision practices of the institution effective?

1.4. Objectives of the Study

1.4.1. The general objective of the study

To assess the practices of credit management of micro- finance institution in Ethiopia the case of Addis credit & saving institution.

1.4.2. The specific objectives of the study were to:

1. To assess the credit policy and procedure of the institution.
2. To examine the practice and the evaluation of credit application of the institution.
3. To assess the effectiveness of credit administration and documentation practice of the institution.
4. To examine the effectiveness of the follow-up and supportive supervision practices of the institution.

1.5. Scope /Delimitation of the Study

This important research was concentrating on credit management practice of Addis credit & saving institution which is operating in Addis Abeba city administration. Emphasis shall be placed on the credit service of the institution. The data were obtained from two sub cities out of ten sub city and eight delivery posts under their domain out of the 29 delivery posts that AdCSI operates. The sub city and delivery posts were limited to two and eight respectively due to logistical and time limitations.

1.6. Limitation of the Study

During the study researchers find some limitations. These includes: lack of enough time and absence of respondents at planned time during data collection. The data were collected from sub city and delivery posts were limited to two and eight respectively due to logistical and time limitations.

1.7. Significance of the Study

MFIs are important for poverty reduction and creating employment opportunity especially in developing countries like Ethiopia. One of the key factors for profitability and sustainability of MFIs is the presence of good credit management practice. The result of this study shall expect to have a great importance to evaluate micro finance institutions in providing efficient and effective services to the poor and lower income group who are in trouble of for start-up business and also for non-business activities such as for education and emergencies purpose. This study tries to provide information for a better understanding on the general aspects of credit management issues like credit policy and procedure, credit application evaluation, credit administration and documentation and follow up, supportive supervision and monitoring of the AdCSI from both lender and borrowers side. The primary advantage of this study is to establish a knowledge base that enables to makes a sound decision and take corrective action. In addition, the information will be useful for policy makers, other lending institutions and stakeholders.

1.8. Organization of the Study

In the remaining part of the paper the following information's are included. The second chapter explains about the review of the related literatures, the third chapter shows research design and methodology, the forth chapter shows the analysis of the data's collected, and finally the last chapter brings the study to an end with findings, conclusion and recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

2.1. Overview Microfinance

Before proceeding to the general concept regarding credit management practice in microfinance institutions, let me define the meaning and basic concepts of microfinance. Different literatures define microfinance in various ways. But the core of the concept revolves around related and similar context. But we use the one defined by Taskforce on Supportive Policy and Regulatory Framework for Microfinance which has similar concept used in this research. Accordingly, Micro financing is the provision of financial services to poor and low income households without access to formal financial institutions (Conroy, 2003). Microfinance is described also as banking for the poor. They are different from commercial banks because, they have limited banking services directed primarily to a designated catchments area or group. The major purpose of Micro Finance Banks is to direct attention of purveying credit to low income group and Micro, Small and Medium Enterprises (MSMEs) (Moruf, 2013).

The World Bank defines microfinance as " Small-scale financial services, primarily credit and savings provided to people who farm or fish and 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" (Robinson, 2001).

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.

2.1.1. Major Micro Finance services

Murray and Boros (2002) stated that the characteristics of microfinance products include: small amounts of loans and savings, short loan terms, payment schedules featuring frequent installments, easy access to the microfinance intermediary, simple application forms which are easy to complete, availability of repeat loans in higher amounts for clients who pay on time.

In addition to financial intermediation MFIs usually use nonfinancial services also named Business Development Services (BDS) (Ibtissem and Abdelfettah, 2013). Some microfinance programs are also referred to 'credit plus' as they provide services such as health services or adult literacy or training that go beyond financial services (Ibtissem and Abdelfettah, 2013). The main objective of these services is to develop client's managerial and technical skills, improve and update their knowledge in production technology. (Edgcomb and Barton, 1998) note that the provision of nonfinancial services as a complement to credit and saving services not only develops the economic ability of the borrower to repay but also makes the relationship with the MFI more valuable to him. So we can say microfinance is not simply banking; it is also a development tool. Some types of services provided by MFls such as:- small loan, typically for working capital, informal appraisal borrowers and investment, collateral substitutes; such as group guarantee or compulsory savings, financial administration of third party, stream lined loan disbursement an monitoring and secure savings products.

2.1.2. Credit & its Role in Financing Micro-Enterprises

In business the word credit means the act of making loan either by ways of direct lending or by post payment for transactions carried at present with transfer of goods / money. More formally credit is defined as an immediate acquisition of fund or something in return for premise to make an appropriate payment in the future. These days credit becomes "the business of financial institutions & the primary basis on which lenders quality & performance judged." Credit enables people to obtain goods or services even if they do not have enough money to pay for them right away.

Credit, transaction between two parties in which one (the creditor or lender) supplies money, goods, services, or securities in return for a promised future payment by the other (the debtor or borrower, such transaction normally include the payment of interest to the lender. Credit may be extended by public or private institution to finance business activities, agricultural operations consumer expenditures, or government projects. Credit is borrowed funds with specified terms for repayment (Ledgerwood, 1999). As ledger wood further stated it when there are insufficient accumulated savings to finance a business and when the return on borrowed funds exceeds to interest rate charged on the loan, it makes sense to borrow rather than post pone the business activity until sufficient savings can be accumulated, assuming the capacity to service the debit exists.

Credit, in reality plays a more powerful economic, social and political role than the economists have admitted. Credit is a powerful weapon. Anybody possessing this weapon is certainly better equipped to maneuver the forces around him to his best advantage. With appropriate credit institutions and credit policies one can lead a society towards a desired shape. Credit creates entitlement to resources. The more credit one can receive the more resources he can command, the more powerful he is. In a given society if one can find out who is enjoying how much credit facility today, it would be easy to predict the socio-economic configuration for tomorrow (Yunus, 1999). A credit expansion, to be successful, must be moderate and must generate productions, and savings, via investments. (Ostlend, 1969)

In urban areas micro-enterprise need working capital to start production. The main problem in micro-enterprises is shortage of capital and promotional services (Wondafrash, 1994). To achieve this it may be necessary to try a different type of financial and promotional institution to be established to address the need of the poor informal operator.

Credit is an important instrument that can be used effectively and productively when it is given to the creditworthy among the economically active poor –people with the ability to use loans and the willingness to repay them. The term economically active poor is used in a general sense to refer to those among the poor who have some form of employment and who are not severely food deficit or destitute (Robinson 2001) . When loans are provided to the poorest people, the borrowers may use the loan for consumption smoothing and may not be able to use the loan effectively for productive purpose (Hulme and Mosley, 1996).

According to Wondafrash (1994), the provision of credit for informal sector (micro-enterprises) promotes the socio-economic development of Ethiopia and its special importance in relation to the issue of employment creation and poverty alleviation. Credit stimulates mass employment at the grass root level. And the financial and promotional institution to micro-enterprises contributes:- create opportunities for self-employment for the vast unutilized manpower resources; bring people together in a sort of group to work together, eliminate or reduce exploitation by informal moneylenders and improve the productive base of the economy and raise employment opportunities and income at the grass root level.

It has been also explained the role of credit in financing micro-enterprises by (Ageba, 2000), "the lack of capital is a major constraint on activities in the informal sector. The provision of credit would therefore, permit these enterprises to expand, produce more projects and hence generate more income and employment."

2.2. Concept of Credit Management

According to Asante (2015), Credit management is one of the most essential activities in any company and cannot be neglected by any entity involved in the supply of credit lines no matter the nature of its business. It is the mechanism to ensure that customers will pay for the products delivered or the services rendered. (Myers and Brealey, 2003) consider it to be made up of techniques and strategies used by an enterprise to ensure that an optimal level of credit and its effective management are kept. This is one aspect of monetary administration including credit examination, credit assessment, and credit scoring and credit reports. (Nelson, 2002) considers credit management as apparently the way by which an enterprise superintends over its credit sales in a manner that creates greater opportunities for making higher profits. This is a prerequisite for any business engaged in provision of lines of credit since it is not possible to eliminate credit risk default.

MFIs and financial institutions mobilize deposits and utilize them for lending. Generally lending business is encouraged as it has the effect of funds being transferred from the system to productive purposes which results into economic growth. The borrower takes fund from these institutions in a form of loan and pays back the principal amount along with the interest. Though the main concern of MFIs are creating financial access to the poor, as its definition implies, sometimes in the non - performance of the loan assets, the fund of the institutions get blocked and the profit margin goes down. To avoid this situation, MFIs should manage their overall credit process. Credit management comprises two aspects; from one angle it is that how to distribute credit among all the needy so that everyone can develop and MFIs also get profit and from the other angle, how to grant credit to various enterprises, individuals and women to avoid credit risk.

Credit management in microfinance is concerned mainly with using the institutions' resource both productively and profitably to achieve a preferable growth. At the same time, it also seeks a fair distribution among the various segments of the society i.e.(poor, youths and women) so that the economic fabric grows without any hindrance as stipulated in the national objectives, in general and the institutions' industries, in particular.

The higher the amount of accounts receivables together with a longer duration, the greater the monetary as well as opportunity costs incurred to sustain them. If these debts are not collected promptly and urgent cash needs surface, a firm may likely resort to borrowing and the opportunity cost translates into the interest expense paid. (Nzotta, 2004) opined that credit management greatly influences the success or demise of banks and other financial institutions.

Credit Management likewise alludes to the proficient mix of four noteworthy credit approach parameters to ensure convenient collection of advances conceded to clients and in the meantime build their trust in and devotion to the financial organization (Horne, 2007). The main variable is an evaluation of the nature of the client's record operation in the establishment. This takes into consideration the correct examination of the capacity of the clients to meet installments promptly. The second strategy variable is that of setting up the right credit period. In this manner, the MFs should give sufficient time to permit loyal customers the chance of deriving the full advantages of the credit. Such period should not be too long to put the bank in a distraught position. The third parameter is the rebate or the sweetener given to clients as a way of inspiring them to reimburse their credit facilities on time. Such sweeteners must be sufficiently appealing before the goal can be accomplished. The last variable looks at the level of expenditure that can be permitted in the recovering of debts. The inference here is that the MFs should not give out credit where the cost to be spent on retrieving the obligation will probably surpass the obligation itself. To mix these variables into a proficient workable framework obliges the establishment of a watchful arrangement, controlling and coordination of all accessible human and material assets (Horne, 2007).

According to (Mante, 2011) credit management involves the setting up of legal and formal systems and policies that will guarantee that the appropriately designated staff are well- positioned to grant credit, the facility goes to the people with the right credit history, the loan is given out for profitable activities or for businesses which have a strong financial and technical viability, the correct amount of credit is disbursed, the credit can be recovered and the flow of management information is sufficient within the organization to allow for effective monitoring of credit activity. He therefore viewed it as the putting in place of systems that act as a check right from the credit granting process to the point of collection.

Credit management is one of the major functions which financial institutions undertake for proper mobilization of funds. The credit management function includes loans & advances. It also involves a large number of activities ranging from credit investigation to contract with borrowers, appraisal, review, follow-up, documentation, nursing, recovery & write- offs. (Njenga, 2014) Safety of a financial institutions loan or advance is directly related to the basis on which the decision to lend is taken, the type and quantum of credit to be provided and the terms and conditions on which the loan will be made available .Consequently, a two- pronged approach is required to be followed to ensure the safety of each loan.

1. Pre-sanction appraisal: - To determine the acceptability of each loan proposal and

2. Post-sanction control:- The post-sanction control involve proper documentation of the facility and the after care or follow up and supervision through monitoring of transactions in the loan amount, scrutiny of periodical statements submitted by the borrower ,physical inspection of the securities and books of account of the borrower, periodical reviews and renewals etc.

2.3. Credit Management Practices

As (Njenga, 2014) the process of managing credit is significant in improving the current credit scoring practices by the lenders. Credit management ensures inclusion of primary predictive factors that cover the full spectrum of relevant qualification criteria and both determines and reveals how they combine to produce outcomes. Credit scoring, which relies on historical data, does not have this capability, nor does it possess a feedback mechanism to adjust factor weightings over time as experience accumulates. The process of managing credit determines which risk factors that pertain to the lending decision within the context of each borrower's situation and the loan product parameters, and then appropriately adjusts the factor weightings to produce the right outcome (Matovu & Okumu, 1996).

Credit management practices integrate judgmental components and proper context into the modeling process in a complete and transparent manner. Some credit management systems lack context because they rely purely on the available data to determine what factors are considered. Credit scoring systems lack transparency because two individuals with identical credit scores can be vastly different in their overall qualifications, the credit score itself is not readily interpretable, and industry credit scoring models are maintained as proprietary, as are their development processes (Gardner, 1996).

2.4. Effect of Credit Management on Financial Performance

Credit management is the method by which you collect and control the payments from your customers. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. A proper credit management will lower the capital that is locked with the debtors, and also reduces the possibility of getting into bad debts. According to Edwards (1993), unless a seller has built into his selling price additional costs for late payment, or is successful in recovering those costs by way of interest charged, then any overdue account will affect his profit.

Effective management of accounts receivables involves designing and documenting a credit policy. Many entities face liquidity and inadequate working capital problems due to lax credit standards and inappropriate credit policies. According to Pike and Neale (1999), a sound credit policy is the blueprint for how the company communicates with and treats its most valuable asset, the customers. Scheufler (2002) proposes that a credit policy creates a common set of goals for the organization and recognizes the credit and collection department as an important contributor to the organizations strategies.

2.4.1. Credit Policy for Micro-Enterprise Loan

It is defined as the tenets and systems set up by top administration that oversee the organization's credit division and investigates execution in the augmentation of credit benefits against set down procedures (Franklin, 2010). It is essentially a situated composition of rules intended to minimize expenses connected with credit while expanding advantages from it (McNaughton, 1996).

The establishment of Micro-finance as an effort by the government to improve the access to loans and savings services for poor people is currently being promoted as a key development strategy to enhancing poverty eradication and economic development (Shreiner, 2005). Micro finance policy depends heavily on the availability and provision of finance. Abimiku (2000) asserted that finance is the main preoccupation of banking industry that brings together the factors of production such as land, labour and entrepreneur into action.

A sound loan policy, established and overseen by the board of directors, reflects favorably on the board and management. When a board sets forth its expectations clearly in writing, management is better positioned to control lending risks, ensure the institution's stability and soundness, and fulfill oversight responsibilities. An effective and up-to-date loan policy increases the likelihood that actual loan documentation and underwriting practices will satisfy the board's expectations. Furthermore, a well-conceived policy clearly and comprehensively describes management's system of controls and helps examiners identify high-risk areas and prioritize and allocate examination time.

Credit administration arrangements involve the credit strategies, credit measures and credit terms. This policy becomes the blueprint which guides the conduct and expectations of all employees entrusted with the responsibility of granting credit and also acts as a benchmark by which performance can be measured against standards set. The Credit Management function incorporates all of a company’s activities aimed at ensuring that customers pay their invoice s within the defined payment terms and conditions. Effective Credit Management serves to prevent late payment or non-payment. Getting it right reinforces the company’s financial or liquidity position, making it a critical component in any business. In the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement (Hoff and Stiglitz, 1990). They pointed out that borrowers and lenders may have differential access to information concerning a projects risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows the expected return and risk of his project, whereas the lender knows only the expected return and risk of the average project in the economy.

Lending institutions are faced with four major problems in the course of undertaking credit activity: a) to ascertain what kind of risk the potential borrower is (adverse selection), b) to make sure the borrower will utilize the loan properly once made, so that he will be able to repay it (moral hazard). C) to learn how the project really did in case the borrower declares his inability to repay and d) to find methods to force the borrower to repay the loan if the borrower is reluctant to do so (enforcement) (Ghatak and Guinnane, 1999).

These problems of imperfect information and enforcement leads to inefficiency of credit market which in turn to default. Thorough credit assessment that takes into account the borrowers` character, collateral, capacity, capital and condition (what is normally referred to in the banking circles as the 5C`s) should be conducted if they are to minimize credit risk. (Mensah, 1999) stressed the importance of credit management as follows:

Credit management process deserves special emphasis because proper credit management greatly influences the success or failure of financial institutions. An understanding of a MFIs credit risk management process provides a leading indicator of the quality of a bank's loan portfolio. The key elements of effective credit management therefore are well developed credit policies and procedures; strong portfolio management; effective credit controls and the most crucial of all a well trained staff that is qualified to implement the system (Tenishu, 2014). Financial institutions must maintain basic credit standards if they are to function well and make credit available to promoters. These standards include a thorough knowledge of the borrowers' business by the officer in charge; reasonable debt equity ratio; marketability and viability of the investment project and other technical capabilities. Credit analysis is in general vital for the officer to judge about the credit worthiness of the borrower as well as the project to which the loan is injected.

Credit management is primarily concerned with the effective management of debtors as well as judicious financing of receivables. The objectives of credit management can therefore be expressively stated as safeguarding the portfolio of the companies" investments in debtors and maximizing operational cash flows. Policies and practices ought to be rigorously enforced for granting credit facilities to customers, collection of repayments that are due and limiting the high risk factor of non-payments.

According to (Tenishu, 2014) this effective credit management policy is particularly important in the case of small-scale entrepreneurs in LDCs like Ethiopia where most of the borrowers don't have sufficient entrepreneurship capacity to conduct scientific study before deciding on investing in a particular project. It would save the borrowers from undertaking risky project as well as the bank from default risk.

Credit risk evaluation is a complex process, which implies a careful analysis of information regarding the borrower in order to estimate the probability that the loan will be regularly repaid (Vigano, 1993). The probability of regular repayment depends on objective factors related to the borrower's operating environment, the borrower's personal attitude towards loan obligation, and the bank's ability to evaluate these two aspects through the information it has and to control credit risk specific contractual conditions. Vigano summarized factors affecting credit risk as follows: the customer's ability and willingness to pay, presence of favorable external conditions, quality of information and MIFI's ability to ensure the customers willingness to pay.

2.4.2. The relationship between credit management policy and credit risk

Liuksila (1996) mentioned that the problems often begins right at the loan application stage and increase further at the loan approval ,monitoring stage especially, when credit risk management guidelines in terms of policy and strategy (procedures) for credit processing do not exist or weak. On the other hand (Koch, 1995) mentioned that adherence to sound credit policy principle farmed by sound credit analysis can reduce the frequency and depth of loan problems. Lending difficulty can be reduced if management established all adheres to loan policy guidelines specify quantitative goals for loan production versus loan quality and indicates procedures to attain these goals.

(Endalkachew,2005) mentioned that lending policy are the concise set of board statement established the concept and objective parameter for credit extension, the organization of lending function including approval and delegation of responsibility. Lending procedure are the detailed approvals and techniques and implementing the stated policy in terms of how credit proposal should be granted and handled, borrower financial information analyzed, credit file mentioned and up dated, control of repayment schedule performed and enforced and periodic review and reports be generated and distributed.

2.4.3. Credit application evaluation

To make prudent credit decision, MIFI essentially should know the borrower well. Without these information MFIS cannot judge the loan application. Credit worthiness of the applicants is evaluated to ensure that the borrower conform to the standards prescribed by the MFIS. It can be said that a loan properly made is half- collected. Therefore, a MFI should make proper analysis before making any credit decision. With increasing credit risks, MFIS have to ensure that loans are sanctioned to „safe‟ and „profitable‟ projects. For this, they need to fine-tune their appraisal criteria. A mix of both formal and non-formal credit appraisal techniques will go a long way to ensure perfection in credit appraisal.

The credit evaluation process involves three steps:

Gathering Credit information, Credit Analysis (credit worthiness of applicants) and Credit Decision

Gathering credit information:

The credit department of a MFI collects various important information regarding borrower from different sources to evaluate the customer. A number of sources would available for gathering information which depends upon the nature of the business, form of loan, amount of loan etc.

Credit Analysis (credit worthiness of applicants)

After gathering the credit information, banker analyses it to evaluate the creditworthiness of the borrower. This is known as Credit Analysis. It involves the credit investigation of a potential customer to determine the degree of risk in the loan. The creditworthiness of the applicant calls for a detailed investigation of the 5 „C‟ of credit - Character, Capacity, Capital, Collateral and Conditions.

Credit Decision

After passing through whole this process, the MFIS has to take decision about sanctioning of credit facility. The creditworthiness should be matched against the credit standards of loan policy. The MFIS should be very conscious about this, for taking right decision to avoid the possible credit risks to arise in future.

2.4.4. Credit Culture/Administration

Credit culture, according to (Kamath et al, 2010) can be defined as a MFI's approach to all issues correlated to the administration of credit risk. He continued by stating that if it is to attain a healthy credit risk portfolio, it must be synchronized with the strategic direction and organizational culture of the financial institution. (Basu and Rolfes, 1995) define credit culture as a structure of shared principles, viewpoints and credit related activities. They further inform that credit culture affects the practices of the financial institution concerning credit management. The culture must have the capacity to deliver the service required by the institution to meet the needs of its clients in a timely manner. It can only do this if it is in harmony with the overall strategic direction of the financial institution and is pioneered by the top echelon of the financial institution. Therefore Middlemiss (2004) states that financial institutions should have a more “morally acceptable approach” to assessing credit and should enact a certain level of social responsibility. Because the credit culture ought to maintain a balance between assuming new risks and imposing limits on the amount of risk at the same time, it is bound to run into all of kinds of resistance. Top management is the only source that can ensure that the culture not only supports appropriate credit standards, but is also profitable enough not to cause the bank to lose out on good business.

Solid credit standards, according to (Rouse, 2002), will unavoidably cost the bank some business, which in retrospect would have been beneficial. However, when the decision is being contemplated on, hindsight is unavailable. Credit culture which is an integral part of credit management takes into consideration the fact that there is some business the bank has to be willing to lose and so it becomes imperative for an agreement to be sought and a consensus reached as to the yardstick to be applied in determining which business to do away with throughout the bank. This policy has to be established by management and should articulate the type and level of risk the bank is ready to accommodate and the return it expects from taking on stated risk levels, both at the customer and portfolio level. In the view of (Gallinger and Ifflander, 2002), credit standards translate the culture into actions. (Middlemiss, 2004) states that financial institutions should have a more “morally acceptable approach” to assessing credit and should enact a certain level of social responsibility. They should consider the terrain of the MFI’s operations, its arrangement and the character and the level of preparedness of staff involved in credit decisions. This enables an effective credit management system to be implemented buoyed by a strong culture that is able to convert policies into proven results

2.4.5. Credit Follow-up, Monitoring and supportive Supervision

(Wood j, 1999), cited that, credit is borrowed funds with specified terms for repayment. When there is no sufficient accumulated savings to finance a business and when the return on borrowed funds exceeds the interest rate charges on the loan, it makes sense to borrow rather than not doing the business activity until sufficient savings can be accumulated; assuming the capacity to service the debt exists. Action Aid (1992), also explains that credit is provided for an activity which involves and needs proper selection of activity, source of funding, detailed planning, implementation of saving components and evaluation.

A proper credit management will lower the capital that is locked with the debtors, and also reduces the possibility of getting into bad debts. According to Edwards (1993), unless a seller has built into his selling price additional costs for late payment, or is successful in recovering hose costs by way of interest charged, then any overdue account will affect his profit. In some competitive markets, companies can be tempted by the prospects of increased business if additional credit is given, but unless it can be certain that additional profits from increased sales will outweigh the increased costs of credit, or said costs can be recovered through higher prices, then the practice is fraught with danger.

As (Wood, 1999), explains that loans are generally made for productive purposes that is, to generate revenue within a business. Some micro finance also make loans for consumption housing or special occasions. So, in order to use the credit properly there should be appropriate credit management, control system and continuous follow up procedure. According to him methods of credit delivery in the micro-enterprise lending program generally can be divided into two broad categories. These are individual and group based lending approaches based on the program delivers and guarantees its loans. Among the above two credit delivery methods group based lending is assumed to be a better credit management system for micro-enterprises lending program (Wood, 1999).

According to Pike and Neale (1999), a sound credit policy is the blueprint for how the company communicates with and treats its most valuable asset, the customers. Scheufler (2002) proposes that a credit policy creates a common set of goals for the organization and recognizes the credit and collection department as an important contributor to the organization’s strategies.

According to (Kipchumba, 20150) in 1990’s loan delinquency was experienced which called for an intervention. Evaluation of customer’s ability to repay the loan was highly suggested but it failed as loan defaults continued (Modurch, 1999). However, the concept of credit management became widely appreciated by MFI’s in the late 1990’s to reduce credit risk but this did not end loan defaults to this date (Modurch, 1999). It is critical to have comprehensive credit assessment in place so as to establish a prospective associates or new loan borrower's creditworthiness. There are a number of universally relevant questions one should ask to initiate credit assessment, whether one is assessing a small new business, established or larger corporation. Credit assessment should be able to qualify, within the limits of borrower's income, for most loans and clients receive the best interest rates available. MFI's serves different range of business people who involve themselves in micro business activities and informal activities. Their credit demands vary depending on their businesses. If client's credit is fair, he or she will probably not have trouble qualifying for a loan, but they may not receive the best available interest rate. Moreover, loan borrowers should identify issues that could limit their ability to qualify for many loans.

2.5. Micro-Finance in Ethiopia

Although an intensive and well educated youths were existed in the economy of the country, lack of financial services to the needy target poor people's through conventional commercial banks were found as a bottleneck for the poor or low-income group peoples to finance their projects. Moreover, the collateral requirements and information asymmetries made by those commercial banks to the large number of poor people on the world have lacked access to formal banking services at all (Litenah, 2009). Abafita (2003) were discussed in his study that a limited access to institutionalized financial service for the poor peoples in Ethiopia enforces the needy society to borrow from iddir, iqub, friends and relatives and other informal lenders to finance their business. As a result, an initiation to establish the formal financial sources was in place to serve those poor people's by discouraging the exorbitant effects of those lenders. The main objectives of the MFIs as development organizations were to serve the financial needs of the non-served and underserved poor people's but who have the ability to work hard and change his/her life style due to the presence of these financial services. The major objectives to meet are as follows: Creating job opportunities, reducing poverty, empowering women, encouraging small and petty trades (Bayeh, 2012 and Tolosa, 2014) In developing countries, like Ethiopia, Microfinance Institutions (MFIs) have been emerged as a financial institutions with an intention of providing small sized financial service to the poor who were in need of financial services but lack of access to formal commercial banks. The microfinance institutions services consists provision of micro loans, micro savings, micro insurance service, money transfer, leasing and other relevant schemes to the target poor peoples who have been excluded by the conventional commercial banks due to lack of collateral requirements and high transaction costs (Tolosa, 2014).

Microfinance institutions in Ethiopia have been evolved since the late 1990s as an economic development tool intended to benefit low income poor peoples (Bayeh, 2012). As Mengistu,

2007 were cited by Abafita, 2003, the credit program by microfinance have been evolved to empower poor households at urban areas of the country in the form of urban credit financing schemes which had actually commenced its operation since 1994. During its commencement this credit scheme was undertaken by some NGOs, Government departments and some donors in inconsistent manner. To resolve this problem the government of Ethiopia took initiatives to develop regulatory frameworks that govern the operational activities of similar industries (Abafita, 2003). As a result Proclamation No.40/1996 has been enacted to govern the operational activities of microfinance industries.

2.5.1. The Policy and Regulatory Practices of Micro-Finance in Ethiopia

According to Degefa D.(2009:3) in Ethiopia microfinance services were introduced after the demise of the derg regime following the policy of economic liberalization. It is taken as a shift from government and NGO subsidized credit programs to financial services run by specialized financial institutions. With this shift some NGO and government micro credit programs were transformed to microfinance institutions. The government has recognized the situation ad issued a micro-financing policy that went into effect on July 5, 1995 under proclamation No. 40/1996. The policy, which is known as the Licensing and supervision of micro-financing institutions, establishes a close partnership between micro-finance institutions and the National Bank of Ethiopia (NBE) (Lemita, 2014). It states the purpose and objectives of such institutions should be in delivering credit and saving services to rural and urban poor.

2.5.2. Characteristics of Microfinance

Microfinance gives access to financial and non-financial services to low-income people wishing to access money for starting or developing income generation activities. Murray and Boros

(2002) stated that the characteristics of microfinance products include: small amounts of loans and savings, short loan terms, payment schedules featuring frequent installments, easy access to the microfinance intermediary, simple application forms which are easy to complete, availability of repeat loans in higher amounts for clients who pay on time.

Credit is linked to savings, and in most cases loan sizes are related to the amount each borrower has saved. Saving can play a significant role in increasing levels of institutional sustainability and enhancing levels of outreach (Reta , 2011). Therefore, MFIs that offer savings facilities have a cheap source of funds for further lending to more sustainable operations. On the other side, voluntary saving builds the equity of poor households and protects them against unforeseen economic and personal crisis (AEMFI, 2010).

McGuire and Conroy (2000) identified three basic characteristics that make MFIs similar in their operation: First, MFIs know their market. The poor are willing to pay for access and convenience. Interest rates are market-oriented, but lending outlets are located near the client, application procedures are simple, and loans are disbursed quickly. Second, they use special techniques to slash administrative costs. Simple procedures are used and approvals are decentralized. Borrower groups often handle much of the loan-processing burden. Third, they use special techniques to motivate repayments. MFIs have developed a range of techniques to ensure high repayment rates, including the use of self-selected groups in which members guarantee each other‘s loans, intensive motivation and supervision of borrowers, incentives for borrowers, progressive lending, and compulsory savings requirements.

2.6. Group Based lending as a credit management practice

Since 1970s, group lending programs have been promoted in many developing countries (Zeller, 1996).The key feature of group lending is joint liability (Reta, 2011). This means all group members are treated as being in default if any one member of the group does not repay his/her loan. Therefore, each member is made responsible for repayment of loans of his or her peers (Besley and Coate 1995). Most schemes give subsequent credit only if the group has fully repaid its previous loan. Loan under joint liability shows, the threat of losing access to future credit incites members to perform various functions, including screening of loan applicants, monitoring the individual borrower’s efforts, and enforcing repayment of their peers’ loans (Zeller, 1996). When performance is measured with a repayment rate, group lending shows a mixed success (Huppi and Feder 1990). Moreover, Besley and Coate (1995) points out that the group lending has both positive and negative effect on repayment rates. The existing theoretical models of peer monitoring assumes that the repayment performance in group-lending program is positively related to the homogeneity of group members with respect to the riskiness of their projects (Stiglitz 1990; Devereux and Fishe 1993; Besley and Coate 1995) cited by (Zeller, 1998).

However, according to Zeller there is little empirical evidence to confirm or reject this hypothesis. Besley and Coate (1995) argues that if social sanctions are not sufficiently strong, group lending may encourage default by members who would have repaid under individual lending. On the other hand, if social sanctions are sufficiently strong, group lending can improve repayment rates by encouraging borrowers to help each other. Despite group lending has several benefits; there are many factors that may undermine the repayment performance in group lending. Zeller (1996) discusses that since the risk of loan default by an individual is shared by his or her peers, a member may choose a riskier project compared to that in the case of individual contract, and may count on other members to repay his or her loan (i.e. adverse selection of risky projects). He further notes that repayment incentives for a good borrower will disappear under joint liability, when he or she expects that significant number of peers will default.

Several studies have been performed on the group lending aspect of microfinance, and most research shows it to be an effective method. Woolcock (2001) builds on the theory that group lending leads to improved performance by the borrowers. He explains that in additional to the support and guidance from the group, there is also a strong incentive for each individual to operate effectively due to one’s personal reputation within the group. Furthermore, since groups generally are formed of members from the same village or community, repaying loans on time and in full affects a borrowers standing within the community at large, not limited to the lending group. However, while this social effect can produce positive outcomes for the microfinance institutions, some researchers believe that it can lead to an unhealthy social environment. Islam (1995) examines the effect of lending groups from the perspective of the microfinance institutions. His study finds that group lending provides a strong system of peer monitoring, which in turn provides the institutions with the ability to be more flexible with their finances, either charging lower rates than other lenders or charging the same rate and receiving higher rates of repayment with lower risks. Although most of the research on joint lending finds positive effects, an empirical study of microfinance institutions and borrowers in Thailand concluded that, contrary to conventional understanding, joint lending does not have a significant effect, either positive or negative, on the repayment of loans (Kaboski and Townsend 2005).

2.7. Addis Credit and Saving Institution (AdCSI)

Addis credit and saving Institution (ADCSI) was established in accordance with the "Licensing and supervision of Microfinance institutions Proclamation No 40/96" on January, 2000 as a share company with a capital of 1,017,000.00 to undertake its activity, in order to facilitate the economic development of the country by increasing the speedy flow of money and encourage small investments by giving some financing opportunities and giving credit facility to the lower income society. Currently the institutions capital raise to 810,509,000.00 & the institution give its service in 10 branches and many sub-braches in Addis Ababa. Addis Credit and saving institution is established to give full support to micro and small scale business operators in Addis Ababa & Oromia region surrounding Addis Ababa, Burayu & Sululta. As per the revised proclamation No. 626/2009, ADCSI has an objective to collect deposits and extend credit to rural and urban farmers, and people engaged in other similar activities as well as micro and small scale rural and urban entrepreneurs.

Addis Credit & Saving Institution has delighted to announce that it moved its head office which is located near to Abune Petros Avenue to the new constructed new building which is located at Churchill Avenue next to electric world building. Currently the institution has 10 branch offices at sub city level, 115 service delivery posts at Woreda level and 17 micro banks (see annex 4). Addis Ababa City Government is the major owner of the company and provides many supports to realize its vision and mission. AdCSI is highly subsidized and gets financial sources (97%) from Addis Ababa City Government (Alehegn 2007). As per the commercial code of Ethiopia, next to the general assembly of shareholders, the highest and the decisive governing body of AdCSI is the Board of Directors (BoDs).

2.7.1. Requirement for loan clients

AdCSI is providing loan for customers only who fulfill the following criteria: individuals above the age of 18 years, residence of Addis Ababa, either engaged or ready to engaged in micro and small scale business, has permanent working place, graduates of technical and vocational training (TEVT) in organized form of cooperatives or business group, license for business activities requiring loan size exceeding 5000 birr, business should be implemented in Addis Ababa and loan taken from the institution or similar institution should be settled before hand (AdCSI, 2002).

The main client screening mechanisms of the institutions are business profitability and experience, interest of doing business, and client's behavior. In order to know the behavior of clients specially for group lending, they were collected historical background from different stockholders such as Women, & Youth associations' and small scale enterprise. In addition, they checked the amount of money requested by the client is enough for doing business or not; they have to control under and over finance. AdCSI has been implemented different kinds of loan guarantee and property collateral mechanisms for the loan. The most commonly used are group guarantee (joint liability), salary of permanent employees of different organization, collateral (a house or vehicle), clients of the institution based on their savings or business enterprise can be used as a guarantee (AdCSI, 2010).

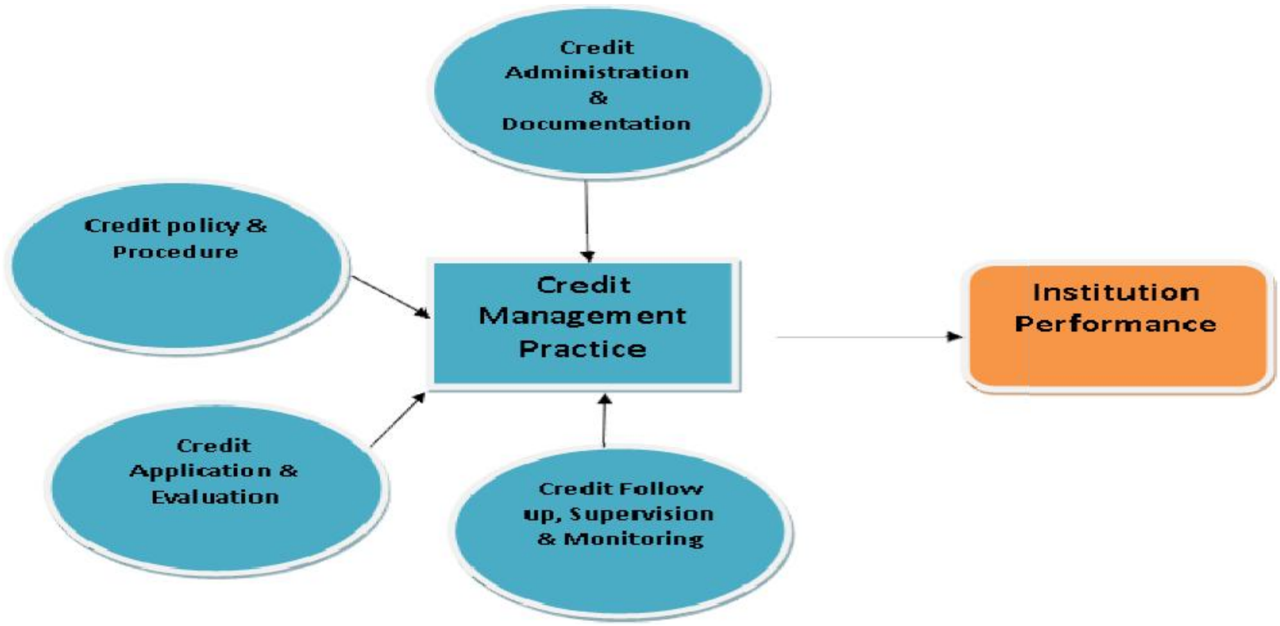
2.7.2. Loan approval delegation

The entry point for all loan services is the services delivery post. Loan of less than 5000 birr can be approved at this level. For loans from birr 5001 to 100,000, the service post makes the necessary business evaluation and writes its comment, which they then transfer to the branch. Based on all the documents and their judgment, the branch office will make the final decision on the loan amount. Loan greater than 100,000 birr will be transferred to the head office, after making the necessary evaluation by both the service post and branch office; the loan approval will be given at this level.

2.8. Conceptual Framework

The theoretical review aims at giving the meaning of a word in terms of theories of a specific discipline. It will contribute to a better understanding of the concept and help in assuming both knowledge and acceptance of theories that relate to credit management practice. The conceptual base for this study was drawn from the theory of self-efficacy postulated by (Bandura, 1995). It "refers to beliefs in one's capabilities to organize and execute the courses of action required to manage prospective situations". According to (Robbins, 2013) judgment of self-efficacy consists of three components which are magnitude, strength and generality. Self- efficacy affects people's thoughts, feelings, actions, motivations, efforts, and determinations to confront the obstacles faced in life. High self-efficacy means that people are more likely to participate in activities in which they believe they can succeed. It promotes the premise that individuals have the potential to mitigate and improve their situations. Finally, the theory identifies factors that affect the success or failure of individuals, including their collective or group actions.

Fig 2. 1 Conceptual Framework for the credit management of the MIFI.



Source: Author's Construct, December, 2018

2.9. Empirical Evidence

According to Davis (2012) there is conflicting data about the true value of finance institution as developmental tools, while many finance institutions advertise high repayment rate and better quality of for their clients. The evidence that a finance institution creates appreciable reduction in poverty is inconclusive. To makes a significant impact finance institutions must be made available to a very broad segment of society and be coupled with entrepreneurial ability on much of the joy of the movements early days has dissipated and few now see finance institutions on its own reduction for global poverty. Despite this emerging sense of realism, there is still a relatively broad consensus that providing financial service to the poor has tangible economic benefit, even if not the instant alleviation of client poverty.

(Nagarajan, 2001) in his study of risk management for financial institutions in Mozambique found that risk management is a changing process that could appropriately be advanced during normal times and tested in the event of risk. It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that risks related losses can be minimized through strong management of portfolio and income streams, by establishing robust institutional infrastructure with proficient human resources and instilling client discipline, through effective coordination of stakeholders. Achou and Tenguh (2008) additionally directed an examination on the performance of financial institutions and credit risk administration and found that an essential relationship of huge significance existed between financial organizations performance (regarding profitability) and credit risk administration (with regards to credit effectiveness). Better credit risk administration brought about a more upbeat performance in financial institutions. Therefore, it is of fundamental importance that monetary establishments teach the propensity for reasonable credit hazard administration, protecting the resources of the organization and securing the interests of investment holders.

This falls in line with one of the goals of the research work which is establish the relationship between credit management practices and institutional performance in credit granting institutions in Ghana with profitability being one of the performance measures to be utilized.

Soke Fun Ho and Yusoff (2009), in their study on credit risk management strategies of selected financial institutions in Malaysia pointed out that "losses incurred by majority of financial institutions and banks emanate from outright delinquency due to the customers‟ inability to fulfill obligations relating to lending, trading, settlement and other financial transactions. Credit risk arises from a bank's transactional activities with individuals, corporate, financial institutions or sovereign entities." A bad loan portfolio can trigger serious liquidity as well as credit risk. According to (Asante, 2015) the proficient administration of credit risk is a fundamental aspect of the entire administration framework of risks which is vital to every bank and in the end the survival of every monetary establishment. It is subsequently imperative that credit choices are made by solid investigations of hazards involved to avoid the eroding of profits. An effective credit administration is a vital part of a far reaching strategy to an enterprise risk administration framework and basic to the

Several studies have been done in regard to credit management on loan management. (Pyle, 1997) in his study on credit management held that financial institutions needed to meet forthcoming regulatory requirements for risk measurement and capital. However, it is a serious error to think that meeting regulatory requirements is the sole or even the most important reason for establishing a sound, scientific risk management system. Managers need reliable risk measures to direct capital to activities with the best risk/reward ratios. They need the estimate of the size of potential losses to stay within limits imposed by readily available liquidity, by creditors, customers and regulators. Mechanisms are needed to monitor positions and create incentives for prudent risk taking by divisions and individuals. (Sindani, 2012) in her study on Effectiveness of Credit Management System on Loan Performance: Empirical Evidence from Micro Finance Sector in Kenya found out that Credit terms formulated by the microfinance institutions do affect loan performance; the involvement of credit officers and customers in formulating credit terms affects loan performance. The study recommended that both credit officers and customers should be involved in formulating credit terms. Interest rates charged had a negative effect on the performance of the loans, the higher the interest rates the lower the loan performance.

(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. (Soke and Yusoff, 2009), in their study on credit risk management strategies of selected financial institutions in Malaysia found that majority of financial institutions losses stem from outright default due to inability of customers to meet obligations in relation to borrowing. This study will establish whether MFIs borrowers in Baringo do meet their loan obligation or not. (Orua, 2009) conducted a study on the relationship between loan applicant appraisal and loan performance of microfinance institutions in Kenya. The study revealed that short-term debt significantly affected MFI outreach positively. Long-term debt however showed positive relationship with outreach but was not significant with regard to default rates. This study is different since the focus is exclusively on short-term debts.

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

This research study has conduct to assess credit management practice in case of Addis credit & saving S.C. It consists of research design, sampling procedure &sample size, types of data and instruments of data collection, methods of data analysis and ethical consideration.

3.1. Research Design

The study incorporated both qualitative and semi-quantitative research. A qualitative research approach is used to assess the opinion of the respondents towards the factors, their assumptions and the problems they faced. Simple quantitative approach was used to indicate the frequency and percentage of the responses. The qualitative approach was used for explaining the actual credit management practice, whereas the quantitative approach is aimed for creating a relationship among the sample and the wider population of the study.

In addition, the researcher used descriptive type of research and tried to describe the credit management practice in case of Addis credit & saving S.C. Descriptive survey was the best for this study because the researcher was able to gather a lot of information by using the relevant tools that gave a broad and reasonably accurate view of the response to certain issues (Peil, 1995).

In this study Semi structured questionnaires were prepared to gather relevant information. The questionnaires were prepared in English language and translated into Amharic for customers to make the questionnaire simple for the respondents. Finally, the collected data from both primary and secondary data were analyzed, summarized, concluded and recommended.

3.2. Data Source

Descriptive research can be done relying on both primary & secondary data's like questionnaires, interviews, group discussion and personal observations, beneficiaries' loan ledger used in this paper to achieve both objectives.

3.3. Primary Data

The primary data were collected by using semi-structured questionnaire and interviews. The interview was assisted by questionnaires. The question include more open-ended type and less of closer –ended and designed in such way that they should generate important information in looking into the opinion of the employees and customers on the institutions credit management system.

Focus group discussion: Two focus group discussions with 24 participants (each group has 12 group members). The group members were selected at training session provided by the institutions head office and the discussions were held at two different days at the end of the training session for 30 minutes.

3.4. Sampling Procedure & Sample Size

Currently, AdCSI has 10 sub city branches, 115 service delivery posts and 17 micro bank service in Addis Ababa. Both random and purposive sampling techniques were used to select the respondents. The random sampling technique was used to select the service delivery posts. The purposive sampling technique was used to select the sub city, the employees and customer respondents. The sub cities were selected purposively based on their large numbers of service delivery posts and large numbers of customers (having around with a total of 8124 customers), and demographic location (West and East). About 76 employees were selected for the survey questionnaire, that is, 66 from the two sub city (Bole and Kolfe) and from eight delivery posts under their domain; and ten from the head office based on their direct job relationship with the information needed by the researcher. Similarly, 96 customers were selected out of the total customer population of 8124 for the survey questionnaire based on 10% error margin. Furthermore, 9 officials were selected from the two sub city branches and the head office for the intense interviews. Likewise, for the focus group discussion, 24 participants were selected from the two sub city branches. The FGD were conducted at head office during the time when they were participated in trainings that were organized by the head office.

Table 3. 11Respondent sample population and size

SN	Population Category	Total Population		Sample Taken			
		Employees + Officials	customers	Employees	customers	FGD - customers	Officials-for Interviews
1	Head Office	100		10			3
2	Bole sub city	98	3759	34	45	12	3
3	Kolfe sub city	95	4365	32	51	12	3
	Total	293	8124	76	96	24	9

(Source-secondary data)

3.5. Secondary Data

At the first stage, the investigator reviewed available secondary data and details, with the official documents in the institution and directly responsible institution's offices, which are helpful in identification of relevant attributes for the purpose of the study. In addition, the researcher exhaustively investigated and used secondary data from beneficiaries' personal ledger (Loan documents). Besides, as reference material ADCS S.C directives, journals working paper as well as different thesis used in the study.

3.6. Data Analysis

Accordingly, the data was collected with different functionaries directly with the help of above said tools and methods. The study was conducted on ADCSI using the above said criteria. The collected data were presented in the form of profile of the ADCSI and qualitative analysis of data. Most of the data that are presented as qualitative analysis obtained from questionnaires and interviews, because, these can bring more ideas that are suitable for this kind of study. Generally, the researcher had considered that, the presentation of profile of the ADCSI and qualitative analysis of data are more suitable and can be applied for the purpose of data analysis. Hence, both qualitative and quantitative approaches were employed in the research to come up with the research.

Finally, generalization was made based on the analyzed and summarized data to create triangulation (questionnaire, interview & group discussion) between the released information through literature review, questionnaire and interview.

3.7. Ethical Consideration

Before the research was conducted, the researcher was informed the participants of the study about the objectives of the study, and was consciously consider ethical issues in seeking consent, avoiding deception, maintaining confidentiality, respecting the privacy, and protecting the anonymity of all respondents. A researcher must consider these points because the law of ethics on research condemns conducting a research without the consensus of the respondents for the above listed reasons.

CHAPTER FOUR

4. DATA ANALYSIS AND INTERPRETATION

Chapter four mainly deals with presentation of data gathered from the interviews (questionnaire) and documents in short and precise manner. The study has dealt with various issues in relation to credit management of Addis Credit & Saving Institution. Basic terms applied in the research such as, concept of credit management, principles of sound lending, loan policy, administration of credit, evaluation of applicant, credit monitoring are defined and discussed for better understanding and clarity in the context of the study and also wider contexts are taken in to account. Firstly, some understandings have been created on the profiles of the selected Micro Finance Institution.

The major objective of the present study is to assess the credit management practices of micro-finance institution with special reference to Addis credit & saving institution by investigating major credit management aspects in their operation in the study area. In order to collect data, various tools and techniques, listed in the previous chapter, were adopted in the study.

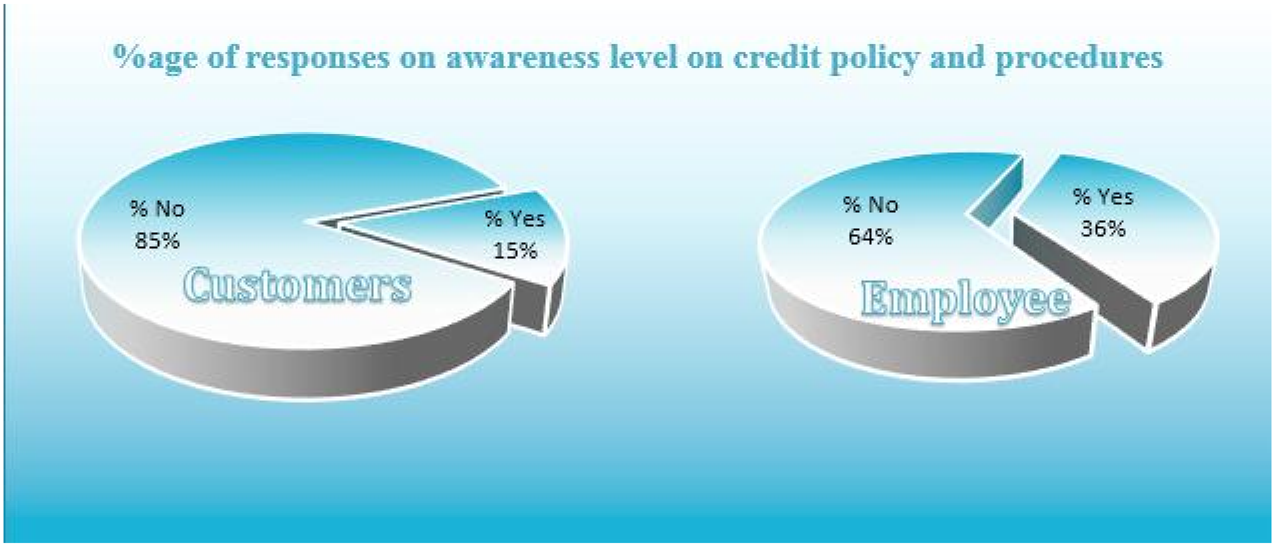
The collected data have been presented in the form of major aspects of credit management and presentation of qualitative analysis. The first part is devoted to the presentation of general information including analysis of the respondents. And the second part is devoted to presentation of detail qualitative analysis on the loan policy, administration of credit, evaluation of applicant and credit monitoring. The data were collected from officials and employees of the institutions and the beneficiaries in the respective areas where the selected institution operated.

4.1. Credit Policy and Procedure

MFIs have to manage lending business in safe manner by that the loan portfolio of MFIs remain balanced from the point of view of size, type, maturity and security that promises for reasonable and steady earnings. This can be done by properly formulating and implementation of credit policy and procedures. These include detailed guidelines for the size of the loan, the maturity periods of the loan, security against loan, the credit worthiness of the borrower, the liquidation of loans, the limits of lending authority, the loan territory etc. So, the loan policy and procedures are necessity for MFIs. Generally, formulating and implementing loan policies and procedures are the most important responsibilities of microfinance institutions, in general and credit management bodies, in particular. Here researcher analyzed and discussed about the effective implementation of the credit policy, procedure and related criteria and standards of the institutions. Accordingly, officials and performers of the institution are asked about the existence of full understanding or knowledge of the credit policy and procedure in order test they knowledge and awareness level about the credit policy.

The result of the data collected from the study participants and the structured interview revealed that the majority (64%) of the respondent admitted that their knowledge level about the credit policy and procedure is limited (fig 4.1) and the reasons according to them are lack of detailed guidelines, inadequate and non-continuous training, lack of appropriate training materials, and low level of focus given by the management, that is, they worried much for the cost of the training and documents; are the major ones (see annex 2). This was confirmed by Tenishu (2014) who stated that the key elements of effective credit management therefore are well developed credit policies and procedures. Similarly, the responses compiled from the customers revealed that the vast majority (85%) of them had not get detailed information about their borrowing, like grace period, the impact of delayed payments and penalties, etc.

Fig 4. 1. Credit policy and procedures awareness



(Source-primary data)

Besides, data collected from the questionnaire from the customers majority (88%) and from the FGD had revealed that they believed the credit policy and procedures of the institution did not consider the real environment where their business working. These include the size of the loan, the maturity periods of the loan, and collateral against loan were not appropriate for them (see annex3). Furthermore, the employees participated in the survey questionnaires were asked that whether the credit policy and procedures were fully employed and the vast majority of the respondent (84%) had believed that the credit policy and procedures were not fully employed due to absence of regular control and checkup activities. During the interview, the researcher has taken the same understanding with that of the cumulative responses. The worst thing we noticed here was that, the probability of amendments the policy and procedure elements that sees inappropriate was very low. That is, the majority (86%) of the employees responded that they did not see such revision at reasonable time (see table below)

Table 4. 1. Summary of analysis of data obtained from survey questionnaires on credit policy and procedure.

SN	Semi-Structured Questions	Responses (No.)		Responses (%)	
		Yes	No	Yes	No
1	Do you have full awareness or knowledge about the credit policy and procedures of the institution?	27	49	36	64
2	Do you think that the policy, procedures and their derivatives have been fully employed?	12	64	16	84
3	Does the loan policy and procedure of the institution are revised at reasonable time for acceptable reasons?	11	65	14	86

(SOURCE-Primary DATA)

4.2. Credit application, appraisal and evaluation process

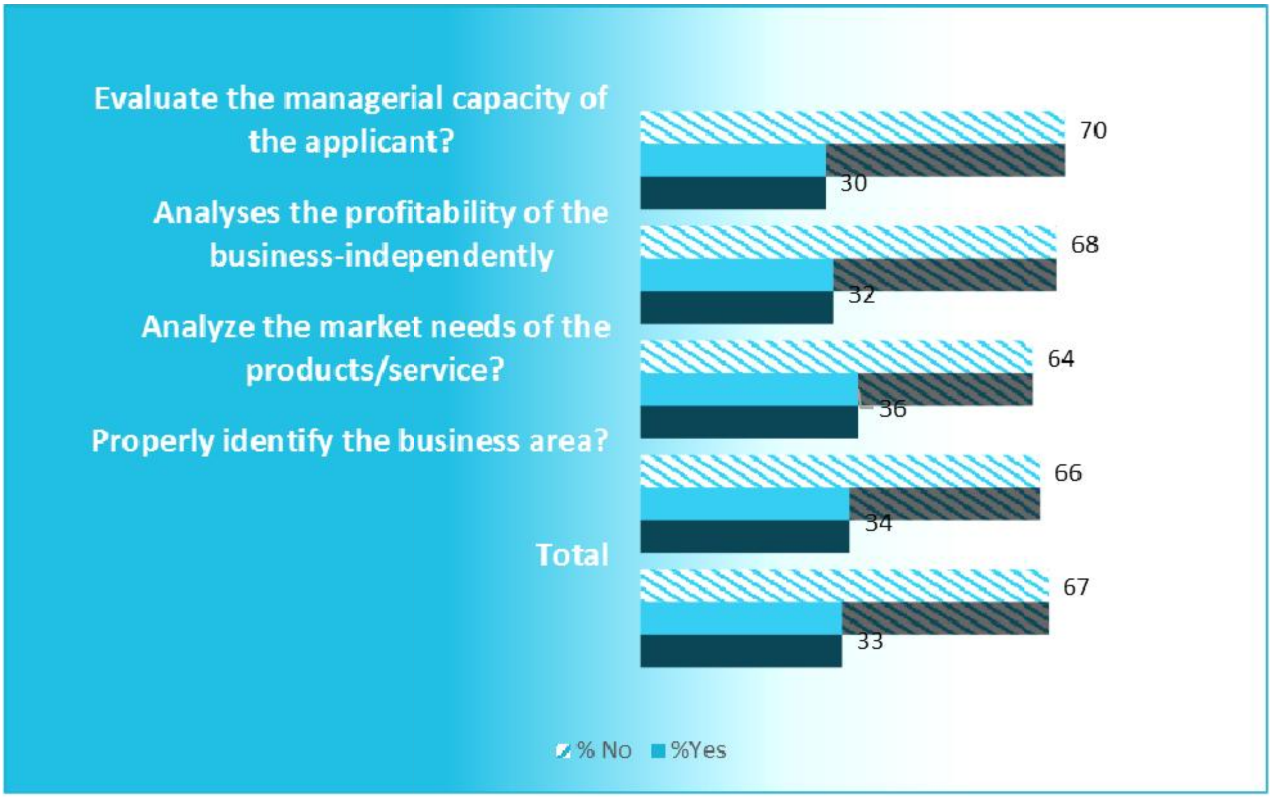
To make prudent credit decision, MFIs essentially should know the borrower well. Without these information MFIs cannot judge the loan application. Credit worthiness of the applicants is evaluated to ensure that the borrower conform to the standards prescribed by the MFIs. It can be said that a loan properly made is half-collected. So, a MFI should make proper analysis before making any credit decision. With increasing credit risks, MFIs have to ensure that loans are sanctioned to safe and profitable business. For this they need to fine tune their appraisal criteria. A mix of both formal and non-formal credit appraisal techniques will go a long way to ensure perfection in credit appraisal. The credit evaluation process involves three steps: gathering credit information, credit analysis (credit worthiness of applicants) and credit decision.

Hence, semi-structured questionnaires are developed by framing this conception in order to draw deep analysis of the institution in this regard. According to the majority (72%) of the respondent from employees believed that the loan eligibility criteria, standards and formats used by the institution were not well developed and lacked elements used to collect quality and complete information about the applicants(see annex 2). This was confirmed by McNaughton (1996) who stated that the firm’s credit analysis should ensure that the loans meet the company’s set credit standards, and that it should follow a typical domestic process flow beginning with data collecting and moving to action observing.

The major reasons for this, according to them, are the different formats (absence of well developed criteria, formats, checklists, standards) used to collect data from the applicants were poorly developed, and this was because, there are critical shortage of skilled officers and facilities on the area. And hence, the credit appraisal system was not effective, according to 70% of the employee participated in the survey study. Similarly, the majority (73%) of respondents, according to the results of the data collected from the study participants from customers (see annex 3) and that of the FGD participants, had confirmed that the formats used by the institution were not clear and understandable to them. Hence, they faced challenges in filling those formats, and most of the time need help to put information in the format. All these had negatively affected the collection of quality and complete information and hence the final decision of loan approval.

After gathering quality and complete credit information, it should be analyzed to evaluate the creditworthiness of the borrower. However, the credit worthiness of the applicants was not properly analyzed. This is because, 70% staff responses, from the data analyzed (see fig. 4.2.), and 68% of the applicants’ files reviewed showed that existence of weak credit worthiness analysis and it was the major problem of the institutions. This analysis was derived based on the result of four major factor of the credit worthiness analysis of the MFIs. These are proper identification of business area, analyze the market, analyses the profitability and evaluation of managerial capacity (see fig.2 below). Furthermore, the document reviewed by the researcher also had confirmed this fact.

Fig 4. 2. Summary of data analyzed on credit worthiness analysis



(SOURCE-Primary DATA)

The figure shows that the summarized responses of factors that determine the credit worthiness of the applicants and the total result revealed that majority of the officers (67%) were disagreed that the credit worthiness of the applicants were properly analyzed.

The major reasons for this as identified by them are incomplete data/information, low quality information, lack of skills by the credit officers, and government policy involvement in the selection process of the customer, document requirement and the standard and eligibility criteria are mainly affiliated by the government policy are the major ones.

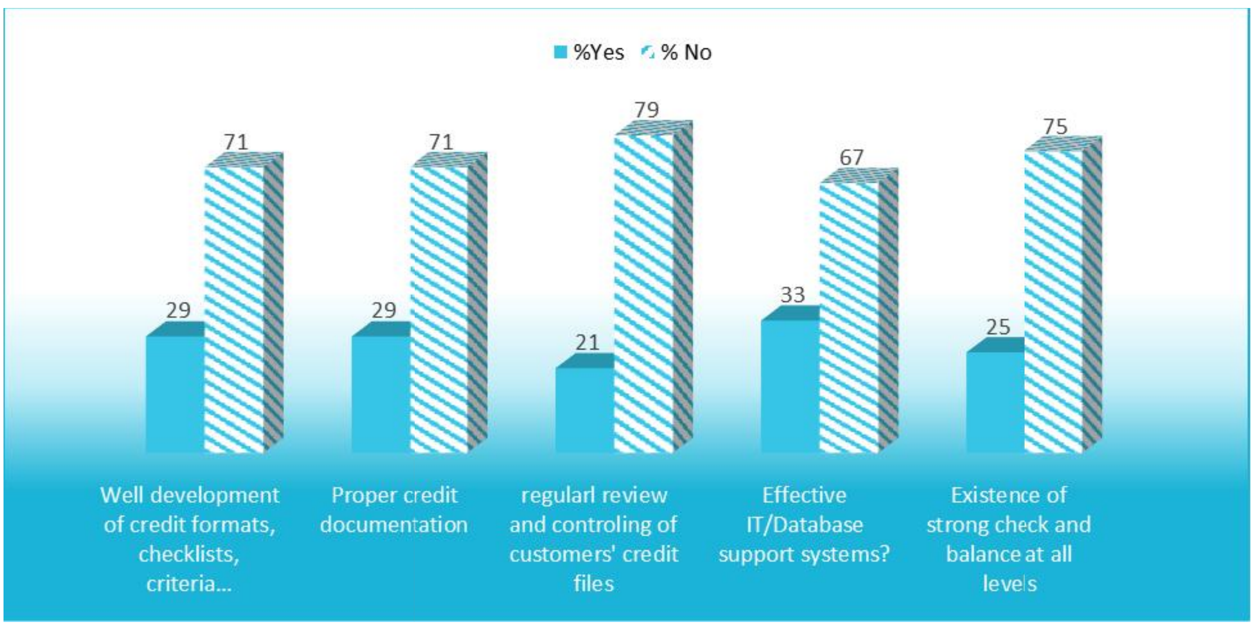
4.3. Credit administration and Documentation

Credit administration is the key components in the active management support of the frontline credit processes of making individual loans and client management. Credit administration (documenting, organizing and managing credit processes) is essential to manage portfolio quality and to operate efficiently. Credit administration is the standards and practices followed in extending, servicing, and collecting loans. Such factors as loan purpose, size, type, and complexity; the borrower's address, premises, collaterals, earnings history, integrity, and ability influence credit administration. Every loan approval process should introduce sufficient controls to ensure acceptable credit quality at origination. The process should be compatible with the MFI’s credit culture, its risk profile, and its capabilities. Further, the system for loan approvals needs to establish accountability. Hence, questions related to the major ideas on credit administration were developed for semi structured questionnaires and interviews like existence of well-established credit administration department, properly preparation of all loan documents and safe custody, existence of well-established reviews and controls system or organ existence of IT/Database systems, existence of fast disbursement of loan facility, and frequently reviewing portfolio / credit and security files were developed to collect quality and complete data on the areas.

Generally, the result of the data analyzed on credit administration and documentation revealed that there are no well-established and functioning credit administration and documentation system. Vast majority (70%) of the staff participated in the questionnaire believed that the institution had not well established and functioning credit administration and documentation systems at the branch level (see fig 4.3.). The major reasons, according to them, were existence of lack of well skilled staffs and adequate facilities (see fig below). According to Kipchumba (2015) credit documentation encompasses the maintenance of orderly up dated credit files and the imposition of relevant fees, updating of records and prompt notification of credit reviews and renewal dates.

Basically, existence of proper credit files documentation, regular reviews and controls of the documents are the key elements of effective credit administration, the institution was very much lag behind in this regards. That is according to 71% of the responses obtained from the staffs participated in the semi-structured questionnaires, showed that there was no proper credit file documentation and 79% of them had described that there was no effective, regular reviews, and controls system. Similarly, the institution had ineffective IT/database systems and weak check and balance across all its branches and delivery posts (according to 67% and 75% of the respondents respectively), and the major reasons for all challenges are shortage of skilled manpower and facilities (see fig and table below). As a result, the customer data were not fully digitalized and not updated regularly. Similarly, the HR documents we reviewed, and showed us that availability of staffs working on credit administration areas is very law that is (38% of the unfilled posts) below the required staffs. Even though, there is informally established check and balance system that discuss and decide on the final approval of the credit, according to the information obtained from the management officials interviewed, but practically there is no formally established check and balance system. Based on the branch visit observation the researcher had also confirmed that the absence of formally established check and balance systems or checker maker arrangements at branch levels that controls inappropriate loans from disbursement.

Fig 4. 3 Summary of data analysis on credit administration and documentation



(SOURCE-Primary DATA)

Hence, the institution has challenges in relation to properly develop and maintain all loan documents, record keeping and safe custody of all type of legal documents. This had created bureaucratic bottlenecks and delays and hence affects customer satisfaction. The majority of the respondents (88%) from the customers participated in the questionnaire had confirmed that they did not provided fast and attractive services (from credit origination to approval) from the institution and the major reasons they identified include existence of service delays, unethical behaviors of some officers, shortage of manpower and facility, weak controls by the managers, absence of working with responsibility by officers are the major ones (See annex 3). Similarly, 75% of the customer participated in the study (and Summaries of the FGD) had revealed that major challenges to them were bureaucratic bottlenecks and delays in service delivery that took major share of their dissatisfaction (See annex 3).Furthermore, the credit disbursement, as a key function of credit administration department, was not in good practices. Even though, there was a clearly bulleted timeline of disbursement based on amount, it was not practiced based on the procedure. According to 58% of the staff participant respondents and 73% of that of the customer had confirmed that the disbursement process were not supported by technology and hence took long time to be disbursed (see annex 2&3).

Table 4. 2. Summary of responses of the survey questionnaire on credit administration and documentation.

<table>
<tr><th colspan="2">Summary of responses</th></tr>
<tr><td>1</td><td>The major reasons that the institution had no well-established and functioning credit administration and documentation systems at the branch level are:
shortage of skilled staffs (both legal and financial)
shortage of office facility
document preparation not participatory</td></tr>
<tr><td>2</td><td>The major reasons that the institutions did not establish effective systems that properly document credit files, and regularly reviews and controls these credit documents with respect to the procedure of the institution:
facility shortage
shortage of skilled manpower</td></tr>
<tr><td>3</td><td>The credit administration and documentation systems were not supported by IT/Database systems at the branch level because of:
Critical shortage of skilled man power
Inadequate availability of facility,
Lack of financial capacity,
Lack of focus and undermined importance by the higher officials</td></tr>
<tr><td>4</td><td>The major reasons/factors for the institution not to have transparent and effective check and balance or control mechanisms at the branch level are:
Lack of adequate HR and facility availability at branch level
At Branch level, the manager has full right to approve/disapprove the credit-with limit, most of the time this authority not implemented responsibly,
Sometimes, there are government involvement for political reasons, and as a result loan are granted without the procedures</td></tr>
</table>

4.4. Credit follow up, supervision and monitoring

One of the most important tasks of MFIs today is the follow up and supervision of the credit provided. They are financing large number of borrowers from different sectors of the economy and consequently the supervision of microfinance credit becomes more challenging than it was before. To ensure the safety repayment of the funds, the MFIs are necessary to follow-up, supervise and monitor the credit based on the following major areas: the business has started or not; use of credit for the purpose it has been sanctioned for; monitoring business performance in terms of production sales, profit etc.; the management capability; status of the collaterals, and examine external factors that affect the business.

In the first place, the inspecting documentation and collateral practices of the institution after disbursement has examined through the questionnaire "Does the institution periodically inspect appropriateness of the credit documents and collaterals before bad things happened?" accordingly, 76% of the respondent has replied that there is no such practice in regular and constant manner(see table 4.3). Similarly, vast majority(64%) of the staff respondents from the institution (table 4.3) and 86% of the respondent from the customers(annex 3) were clearly stated that there is no strict, timely and regular follow up, supervision and monitoring activities. Here we can understand that the responses from the staffs and the customers had huge difference regarding the provision of supportive follow-up and monitoring. The customers expressed the case as irregular visits done by officers and it mostly focuses on supervising their business activities and functionalities of defaulters. According to Robinson (1962), many of the agonies and frustrations of slow and distresses credits can be avoided by good loan supervision. Supervision helps keeping good loan portfolios. However, in both cases the activities were not adequate and effective. The major reasons according to the staffs were presented as follows.

Among the major reasons for inadequate follow-up, supervision and monitoring activities, the following are responses as spelt out by the respondents. These are:

- Lack of manpower and facilities, particularly transportation
- priority for new customers, rather than follow up for existing customers
- Weak documentation information system, as a challenge for follow up.
- Lack of skill and knowledge on the issue

- Negative understanding by the customers about the follow up and supportive supervision.

Furthermore, the institution's culture of regular execution of customer repayment status analysis and collecting information about business activities has examined by the researcher. Accordingly, 74% of the functionaries of the institution have responded that the institution has no such culture (see table 4.3). However; such activities are undertaken inconsistent way and when challenges were happened. The other most important thing in microfinance institution is establishing strong penalty system before they fall into the default status. In this regard, the AdSCI had best achievement as per 66% of the officials participated in the study had responded. This is because; penalties are attached for each month payment delay and it considered as income for the institution.

Table 4. 3 . Summary of analysis of data obtained from survey questionnaires on credit follow-up, supervision and monitoring- for staffs

sn	**Semi-Structured Questions**	**Responses (No.)**		**Responses (%)**	
		Yes	No	Yes	No
1	Does the institution periodically inspect appropriateness of the credit documents and collaterals before bad things happened?	18	58	24	76
2	Did the institution has regular and well-established credit follow-up, supervise and monitor system to ensure the safety and repayment of the funds	27	49	36	64
3	Did the institution have sufficient HR, materials and facilities to provide follow-up, supervise and monitor activities	19	57	25	75
4	What are the main/major tasks undertaken by the department/team/officer				
5	Did the follow-up, supervise and monitor system undertake customer repayment analysis before the follow-up	20	56	26	74
6	The institution does always monitor that fund properly utilized for what it has been granted?	7	69	9	91
7	Is there consistent and continuous review of active borrowers' files and analyze their status as substandard, doubtful and loss?	27	49	36	64
8	Doe the institution employ /effective penalties and use legal means on late repayment and default borrowers?	50	26	66	34
9	Does the institution establish early notification systems to borrowers before they get into the default status?	16	60	21	79

(SOURCE-Primary DATA)

Undertaking consistent review and preparing and compiling quality reports on active borrowers by analyzing their status like as substandard, doubtful and loss are the most important activities of the follow-up and monitoring section of the microfinance institutions. However, these practices were not given due consideration in AdSCI. The data analyzed had confirmed these facts, that is, around 64% of the staffs participated in the survey questionnaire had responded that there were no consistent and continuous review of customer files as per the procedures and credit policy of the institutions. Similarly 79% of them were also responded as absence of regular and early notification systems (see table 4.3).

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1. Conclusion

- Majority of the staffs of the institution have limited awareness about the credit policy and procedures. This is due to lack of sufficient training in regular and continuous manner, unavailability of appropriate materials and low level of initiatives by the performers. Hence, the credit policy and procedures of the institution are not fully practiced.
- The institution did not properly collect information about its borrowers in order to evaluate their eligibility.
- Their main focus while evaluating the customer credit application is the presentation of business plan as criteria of eligibility. The institution use business plan along with few interviews as a major source of information about their borrowers.
- As a result most of the borrowers' documents are incomplete and eligibility criteria were not met because the document requirement and the standard and eligibility criteria are mainly affiliated by the government policy (micro and small enterprise cases)
- The creditworthiness analysis of the borrowers was not adequate, this is because the business area, the market need, the profitability of the business, and the managerial capacity were not properly analyzed.
- even though there is formally established check and balance system, there are high tendencies making credit decision without maintaining the standard and criteria based on the credit policy
- Regarding credit administration and documentation, like technical support, establishment of effective credit administration system, regular document review like collateral reevaluation, legal document management, etc were not properly undertaken,
- The institution did not properly identify the working place of majority of its customers as a result it is difficult to provide technical support on the job.
- Furthermore, the institution has no well establish management system for credit administration like absence of computerized credit administration systems and document record. Even it has basic difference in credit administration from branch to branch.

- The branches also have luck of sufficient staffs and materials in relation to credit administration. Accordingly, the credit documents, events, activities are not properly managed as per the credit administration concepts and ideas
- More importantly, the institution did not establish early notification systems regarding deadlines, interest due, penalties etc, which have most significant impact on customer repayment since majority of its customers are not at proper literacy level.
- One of the most important tasks of MFIs today is the follow up and supervision of the credit provided.
- However, the institution has no regular and timely follow up, supervision and monitoring activities. The major reasons for this are lack of manpower and facilities, particularly transportation; priority for new customers, rather than follow up for existing customers; weak documentation information system, as a challenge for follow up; lack of skill and knowledge on the issue; and negative understanding by the customers about the follow up and supportive supervision.
- Even, the existing few follow-up, supervise and monitor activities are not undertaken based proper and prior collection and analysis of customer information, and also did not bring any valuable actions
- All these have largely affects the financial performance of the institution

5.2. Recommendation

- Based on the forgoing major findings of the study the following recommendation can be made for further growth and effective credit management(Credit Policy and Procedure, credit application evaluation, credit administration and Documentation and Credit follow up, supervision and monitoring) of the institution.
- According to the analysis majority of the staffs of the institution have limited awareness about the credit policy and procedures this is due to lack of sufficient training in regular and continuous manner, unavailability of appropriate materials, low level of initiatives by the performers. Thus, the institution has to provide training and necessary material to the staff in order to increase their knowledge level about the credit policy and procedure.
- The institution should checks the borrower history before granting loans and properly assessed the customer ability to meet obligations in credit processing or appraisal system and properly assess the customer ability to meet obligations.
- The institution should carry out routine monitoring of clients in order to know their financial behavior and utilization capabilities. This can be done before, during and after extending loans to these borrowers. Furthermore, before loan process begins the institution should give necessary information to borrower about credit policy and procedure.
- Loan repayments were found to have a strict installment policy which sometimes made it difficult for customers to meet commitments when unexpected situations arise.
- The institution should focus on creating and maintaining a clear, fast, and sharp communication between management team, employees and stakeholders in order to make effective communication to credit risk of the institution.
- The institution has to establish well management system for credit administration and documentation like absence of computerized credit administration systems and document record.
- Follow up the implementation credit policies and standards that conform to regulatory requirements and the institution‘s overall objectives and improve the miss implementation of the institution credit management policies or procedure. Cope up to the changes of credit management policies with the regulatory body or organ. Furthermore, the institution needs to allocate sufficient staff.

- Finally, one of the strong recommendations that have been presented is that management needs to put in place measures to ensure that credit officers comply fully with the credit delivery policies of the institution. One major weakness that was identified earlier from the findings was the lack of effective monitoring of loans given out by institution due to a lack of supervision.

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ANNEXES

Annex 1: Survey questionnaire

ST.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MBA IN ACCOUNTING AND FINANCE

QUESTIONNAIRE

Dear respondents,

This questionnaire has been prepared in view of assessing the practices in credit management of Addis credit & saving institution. The primary objective of the questionnaire is to collect data, information & opinion for the conduct of a senior essay for partial fulfillment of the requirement for award of MBA in accounting and finance.

Your valuable responds would help the researcher to find out the credit management practices & thus highlight the alternative solutions to problems.

Thank you in advance for your valued time & cooperation, the researcher believes that your genuine response, opinions & views are used only for academic purpose & also kept confidential.

N.B pleases give your answer on the space provided & put tick mark in the box corresponding to your response. ☐

Part I: Background of the respondents (Employee)

1. Name of Borrower_____________________ 1.2 Age__________

2. Sex Female ☐ Male ☐

3. Marital Status Single☐ Married☐ divorced☐ Widowed☐

4. Educational level Illiterate☐ Grade1-8☐ Grade 9-12☐ above grade 12☐

Part II. Background of the respondents (Employee)

1. Sex Male ☐ Female ☐
2. Age group 20 – 29 ☐ 30 – 39 ☐ 40 – 49 ☐ above 50 ☐
3. Highest Educational Level Obtained

   Diploma ☐ Degree ☐ Masters and above ☐
4. Current position

   Clerical ☐ Professional ☐ Managerial ☐
5. Bank related work experiance

   0-5 Years ☐ 6-10 Years ☐ 11-20 Years ☐ above 20 Years ☐

PART II: QUESTIONERS TO ASSESS THE CREDIT MANAGEMENT PRACTICES

Nature of Questions

1	2	3
Yes	No	Explanatory

A. FOR EMPLOYEE

I. On credit policy and procedure

1. Do you have full understanding or knowledge about the credit policy and procedures of the institution? Yes ☐ No ☐
2. If your answer to Q1 is no, what are the major reasons not to have the full understanding or knowledge about the credit policy and procedures of the institution (please, list 5 major reasons only)?
3. Do the institution collect complete information and sufficiently analyze the credit worthiness of its customers? Yes ☐ No ☐
4. If your answer to Q3 is yes, which credit information are given more emphasis in analyzing the credit worthiness of the customers?
5. If your answer to Q3 is no, what are the major reasons not doing sufficiently credit worthiness analysis of the customers?
6. Do you think that the policy, procedures and their derivatives have been fully employed?

   Yes ☐ No ☐

7. Does the loan policy and procedure of the institution are revised at reasonable time for acceptable reasons? Yes ☐ No ☐

II. Credit application evaluation

1. Do you think that the loan eligibility criteria, standards and formats used by the institution are well developed and important to collect complete information and to identify the right credit applicants? Yes ☐ No ☐
2. If no, please, mention major challenges you identified with regard to eligibility criterion, standards and other formats that needs improvements?
3. Does the institution have credit appraisal process procedure? Yes ☐ No ☐
4. If your answer to Q3 is yes, did the institution sufficiently analyze the credit worthiness of the applicant based on the credit appraisal process procedure, that is?
   A. Properly identify the business area? Yes ☐ No ☐
   A. Analyze the market needs of the products/service? Yes ☐ No ☐
   B. Analyses the profitability of the business-independently? Yes ☐ No ☐
   C. Evaluate the managerial capacity of the applicant? Yes ☐ No ☐
5. If your answer to Q4 is no, then what are the major reasons?
6. Does the institution has a check and balance establishment at branch level? Yes ☐ No ☐
7. If your answer to Q6 is yes, did the check and balance system effectively implemented, particularly, in credit approved so far?
8. If your answer to Q7 is no, what are the major factors that affect the final credit decision?

III. Credit administration and documentation

1. Do you believe that the institution had well established and functioning credit administration and documentation systems at the branch level? Yes ☐ No ☐
2. Did the credit administration department properly prepare all loan documents, record keeping and safe custody of all type of legal documents? Yes ☐ No ☐
3. If your answer to Q6 is no, list the major reasons?
4. Did the institution established effective systems that properly document credit files, and regularly reviews and controls these credit documents with respect to the procedure of the institution? Yes ☐ No ☐

5. If your answer to Q6 is no, how it is controlled?
6. Did the credit administration and documentation systems supported by IT/Database systems at the branch level? Yes ☐ No ☐
7. If your answer to Q6 is no, Please list 5 major reasons?
8. Does the institution has a culture of fast disbursement of loan facility once security documents are complete based on the guideline? Yes ☐ No ☐
9. If your answer to Q6 is no, what are the major reasons?
10. Is there mechanisms that frequently reviewing portfolio / credit and security files (collaterals)? Yes ☐ No ☐
11. Did the institution had transparent and effective check and balance or control mechanisms? Yes ☐ No ☐
12. If your answer to Q6 is not what are the major reasons/factors?

IV. Credit follow-up, supervision and monitoring

1. Did the institution has well established credit follow-up, supervise and monitor system to ensure the safety and repayment of the funds? Yes ☐ No ☐
2. If your answer to Q6 is yes, at what level the credit follow-up, supervise and monitor system established?
3. Did the institution have sufficient HR, materials and facilities to provide effective follow-up, supervise and monitor activities? Yes ☐ No ☐
4. How often the follow-up, supervise and monitoring activities are undertaking?
5. What are the main/major tasks undertaken by the department/team/officer? Yes ☐ No ☐
6. Did the follow-up, supervise and monitoring system undertake customer repayment analysis? Yes ☐ No ☐
7. Does the institution always monitor that fund properly utilized for what it has been granted? Yes ☐ No ☐
8. Is there consistent and continuous review of active borrowers' files and analyze their status as substandard, doubtful and loss? Yes ☐ No ☐
9. Doe the institution employ /effective penalties and use legal means on late repayment and default borrowers? Yes ☐ No ☐
10. Does the institution establish early notification systems to borrowers before they get into the

default status? Yes ☐ No ☐

B. FOR CUSTOMERS

I. CREDIT POLICY AND PROCEDURE

1 Did the institution fully informed you about the credit policy of the institution that are relevant to you? Yes ☐ No ☐

2 Do you think the credit policy and procedures of the institution were developed by taking the real environment where your business working in to consideration? Yes ☐ No ☐

3 If your answer to Q2 is no, what are the inappropriate issues existed in the credit policy and procedures that are not appropriate to your business?

II. CREDIT APPLICATION EVALUATION

1. Did the format and other documents used in credit process are clear and understandable to you? Yes ☐ No ☐
2. Do you have awareness about the information asked by the institution using the formats (criterial, checklists, credit information formats)? Yes ☐ No ☐
3. Do you think the criteria and standards are appropriate to you? Yes ☐ No ☐

III. CREDIT ADMINISTRATION AND PROVISION:

1. Did you get fast and attractive services (from credit origination to approval) from the institution? Yes ☐ No ☐
2. If your answer to Q1 is no, mention the major challenges you had faced in processing your loan?
3. Do you get the credit on time? Yes ☐ No ☐
4. If your answer to Q3 is no, what are the major reasons?
5. Does the credit format clear and easily understandable? Yes ☐ No ☐
6. Do you well and clearly notified about strict debts collection deadlines and penalties? Yes ☐ No ☐

IV. CREDIT FOLLOW-UP, SUPERVISION AND MONITORING

1. Did they provide timely and regular supportive supervision to you? Yes ☐ No ☐
2. If your answer to Q1 is yes, how often the follow-up, supervise and monitor undertaken?
3. Does the institution establish early notification systems to borrowers before they get

into the default status? Yes ☐ No ☐

4. Do you have ever been in default payment status? Yes ☐ No ☐
5. If your answer to Q4 is yes, does they penalized you for the default? Yes ☐ No ☐

PART III

Nature of Questions

C. GENERAL QUESTIONS

1. What are the main challenges do you think your credit and saving organization will face in implementing any necessary change to your current credit management process? (Filled by employees only)
2. ____
3. What is your advice for the institution in order to solve the credit management practices problems?____
____
____
4. What extra elements do you think could be incorporated into your credit management process to make it stronger? ____

Annex 2: Summary of Analysis of Data Obtained from Survey Questionnaires for Staffs

SN	Semi-Structured Questions	Responses (No.)		Responses (%)	
		Yes	No	Yes	No
I	CREDIT POLICY AND PROCEDURE				
1	Do you have full awareness or knowledge about the credit policy and procedures of the institution?	27	49	36	64
2	If no, what are the major reasons not to have full understanding or knowledge about the credit policy and procedures of the institution? List the major ones? Ø Lack of detailed guidelines Ø Inadequate level of training Ø Regular and continuous Ø Lack of appropriate materials Ø Low level of focus given by the management (cost reasons)				
3	If yes, how did these awareness and knowledge were created?				
4	Do you think that the policy, procedures and their derivatives have been fully employed?	12	64	16	84
5	if yes, why?				
6	Does the loan policy and procedure of the institution are revised at reasonable time for acceptable reasons?	11	65	14	86
II	CREDIT APPLICATION EVALUATION				
1	Do you think that the loan eligibility criteria, standards and formats used by the institution are well developed and had important elements that used to collect quality and complete information and to identify the right credit applicants?	21	55	28	72
2	If no, please, mention major challenges you identified with regard to eligibility criterion, standards and other formats that needs improvements?				
	* Absence of well-developed criteria, formats, checklists, standards,				

	* Shortage of credit officers and facilities				
4	Do the institution has effective credit appraisal process procedure?	23	53	30	70
5	Did your institution sufficiently analyzed the credit worthiness of the applicant based on the credit appraisal process procedure, that is?	25	51	33	67
	Properly identify the business area?	26	50	34	66
	Analyze the market needs of the products/service?	27	49	36	64
	Analyses the profitability of the business-independently	24	52	32	68
	Evaluate the managerial capacity of the applicant?	23	53	30	70
10	If you think that the credit worthiness of the applicant did not analyzed based on the credit appraisal process procedure, then what can be the major reasons? * incomplete data/information * low quality information * lack of skills by the credit officers * government policy involvement				
III	CREDIT ADMINISTRATION AND DOCUMENTATION				
1	Do you believe that the institution had well established and functioning credit administration and documentation systems at the branch level? That is,	23	53	30	70
2	Did the department properly prepare all loan formats, checklists, criteria etc.?	22	54	29	71
3	if no, list the major reasons shortage of skilled staffs (both legal and financial) shortage of office facility document preparation not participatory				
4	Did the institution established effective systems that properly document credit files?	22	54	29	71
5	Did the institution established effective systems that undertakes regularly reviews and controlling of customers' credit files?	16	60	21	79

6	If no, what are the major reasons? * Staff shortage * Facility shortage				
7	If no, how it is controlled?				
8	Did the credit administration and documentation systems supported by IT/Database systems at the branch level?	25	51	33	67
9	If no, what are the major reasons? * shortage of trained manpower on the area and in * availability of facilities at branch level • Lack of financial capacity, • Lack of focus and undermined importance by the higher officials				
10	Does the institution has a strong check and balance establishment at branch level?	19	57	25	75
11	Is there fast disbursement of loan facility once security documents are complete based on the guideline?	32	44	42	58
12	If no, what are the major reasons?				
13	If no, what are the major factors that affect the final credit decision? * Lack of adequate HR and facility availability at branch level * At Branch level, the manager has full right to approve/disapprove the credit-with limit, most of the time this authority not implemented responsibly, * Sometimes, there are government involvement for political reasons, and as a result loan are granted without the procedures				
IV	CREDIT FOLLOW-UP, SUPERVISION AND MONITORING				
1	Does the institution periodically inspect appropriateness of the credit documents and collaterals before bad things happened?	18	58	24	76
2	Did the institution has regular and well-established credit follow-up, supervise and monitor system to ensure the safety and repayment of the funds	27	49	36	64
3	"If yes, at what level the credit follow-up, supervise and monitor system established?				

4	Did the institution have sufficient HR, materials and facilities to provide follow-up, supervise and monitor activities	19	57	25	75
5	How often the follow-up, supervise and monitor undertaken?				
6	What are the main/major tasks undertaken by the department/team/officer				
7	Did the follow-up, supervise and monitor system undertake customer repayment analysis before the follow-up	20	56	26	74
8	The institution does always monitor that fund properly utilized for what it has been granted?	7	69	9	91
9	Is there consistent and continuous review of active borrowers' files and analyze their status as substandard, doubtful and loss?	27	49	36	64
10	Doe the institution employ /effective penalties and use legal means on late repayment and default borrowers?	50	26	66	34
11	Does the institution establish early notification systems to borrowers before they get into the default status?	16	60	21	79

(Source-primary data)

Annex 3: Summary of Analysis of Data Obtained from Survey Questionnaires for Customers

SN	Semi-Structured Questions	Responses (No.)		Responses (%)	
		Yes	No	Yes	No
I	**CREDIT POLICY AND PROCEDURE**				
1	Did institution fully informed you about the credit policy of the institution that are relevant to you? Yes/No	14	82	15	85
2	Do you think the credit policy and procedures of the institution were developed by taking the real environment where your business working in to consideration?	12	84	12	88
3	If no, what are the inappropriate issues existed in the credit policy and procedures that are not appropriate to your business?				
	the size of the loan,				
	the maturity periods of the loan,				
	security against loan				
II	**CREDIT APPLICATION EVALUATION**				
1	Did the format and other documents used in credit process are clear and understandable to you?	26	70	27	73
2	Do you have awareness about the information asked by the institution using the formats (criteria, checklists, credit information formats)?	26	70	27	73
3	Do you think the criteria and standards are appropriate to you?	21	75	22	78
III	**CREDIT ADMINISTRATION AND PROVISION:**				
1	Did you get fast and attractive services (from credit origination to approval) from the institution?	12	84	13	88
2	if no, mention the major challenges you had faced in processing your loan?				
	* Every process has delays				
	* the officers did not treat us well				
	* Shortage of manpower and facility				
	* weak controls by the managers, absence of working with responsibility by officers				
4	Do you get the credit on time?	26	70	27	73
5	what are the major reasons?				
	Service delivery delays				
	* Bureaucratic bottlenecks				

	* Dissatisfaction				
7	Do you well and clearly notified about strict debts collection deadlines and penalties?	40	56	42	58
IV	**CREDIT FOLLOW-UP, SUPERVISION AND MONITORING**				
1	Did they provide strict timely and regular supportive supervision to you?	13	83	14	86
2	How often the follow-up, supervise and monitor undertaken?				
3	If yes, what is the main focus area during visit?				
4	Does the institution establish early notification systems to borrowers before they get into the default status?	12	84	12	88
5	Do you have ever been in default payment status?	64	32	67	33
6	If yes, does they penalized you for the default?	45	51	47	53

(Source-primary data)

Annex 4

List of AdCSI 2018 service delivery post with respect to number of Human resource & number of clients.

SN	sub city	Number of service delivery post	Number of employees	Number of clients
1	Head Office	1	100	1,419
2	Bole	14	98	19,859
3	Arada	10	74	14,185
4	Addis Ketema	10	72	14,185
5	Lideta	10	59	14,185
6	Kirkos	11	71	15,604
7	Yeka	13	113	18,441
8	Akaki	9	72	12,767
9	Nifasilk Lafto	13	101	18,441
10	Kolfe	15	95	21,278
11	Gullele	10	81	14,185
	Total	**115**	**836**	**164,550**
	Microbank	17	497	24,115
	Total	**132**	**2269**	**188,665**

(Sources: compiled from secondary data)

Annex 4

D. **FGD instrument for beneficiary**

Group Code: ___________

No. of participant: _________

1. What do you know about the Institution?
2. What are the importance and weakness of the training provided by the institution?
3. What changes do occur in your business due to the support?
4. What are the good practices and challenges of credit application process of the institution?
5. What are the technical supports and related challenges? How they do important to your business?
6. What are the importance and weakness of the follow-up, supervision and monitoring activities of the institution?
7. Does the local institution cooperate with the LGO to solve the problems of your business?

የቡድንውይይትመመሪያ-ለተጠቃሚዎች

የውይይት ቡድኑኮድ: ___________

የተሳታፊውብዛት፡ _______

1. ስለድርጅቱ ምን ምን ታውቂያለሽ/ታውቃላችሁ?
2. ድርጅቱ የሚያደርግላችሁ ድጋፎች ምን ምን ናቸው? ጠቀሜታቸውንና ያሉባቸው ችግሮቻቸው ግለጹ?
3. ድጋፎቹ በንግድ እንቂስቃሴያችሁ ላይ ያመጣው ለውጥ ምንድን ነው?
4. በብድር ተቋሙ የሚሰጣችሁ ሌሎች ቴክኒካል ድጋፎች ምን ምንም ናቸው? ችግሮቻቸውስ? ንግድዎን ለማሳደ ግእንዴት ጠቀመዎት?
5. የብርድተቋሙየክትትልድና ጋፍ ተግባሩምንምንጠቃሚተግባራትናተግዳሮቶችአሉበት?
6. የብርድተቋሙ ከሌሎች የማህበረሰብ ተቋማትና የመንግስት ተቋማት ጋር በትብብር በመስራት እና እናንተን የሚደግፍበት ሁኔታዎች ምን ይመስላሉ;
7. ድርጅቱ የሚያደርጋቸው ድጋፎችና አገልግሎቶች እንዴት ነው ወደ እናንተ የሚያደርሰው (ማለትም ከውጥታማነት አንጻር-ከግዜ፣ከቦታ፣ ከወጭ እና አገልግሎት ወደ እናንተ ከሚደርስበት ዘዴ አንጻር)?

DECLARATION

I, Tilahun Gemechu declare that this thesis the topic entitled “Assessment of Credit Management practices of MIFIs in Ethiopia: (the Case of Addis Credit & Saving institution)”. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or full to any other higher learning institution for the purpose of earning any degree.

Tilahun Gemechu Signature ———————————

St Mary’s University,

Addis Ababa

December, 2018

ENDORSEMENT

Thesis has been submitted to ST.MARY`S University, School of Business, for examination with my approval as a University advisor.

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Advisor Signature

StMary’sUniversity

AddisAbaba

December, 2018