

**PERFORMANCE OF MICRO FINANCE INSTITUTIONS IN
CREDIT RISK MANAGEMENT:
A CASE OF MBINGA COMMUNITY BANK**

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By

**A Dissertation Submitted in Partial Fulfillment of the Requirements for Award of
the Degree of Master of Science in Accounting and Finance (MSc) of the Mzumbe
University**

**2014
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CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation entitled **Performance of micro finance institution in credit risk management: A case of Mbinga Community Bank**, Headquarters in partial/fulfilment of the requirements for award of the Master degree of Accounting and Finance Mzumbe University.

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I, EDSON WILSON, declare that this research report is my own original work and that it has not been presented to any higher learning institute for a similar or any other degree award.

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LIST OF ABBREVIATIONS

MCB	-	Mbinga Community Bank
BoT	-	Bank of Tanzania
MFI	-	Micro Finance Institution
CRM	-	Credit risk Management.
PAR	-	Portfolio at Risk.
RR	-	Repayment Rate
CRMC	-	Credit Risk Management Committee
CAR	-	Capital Adequate Ratio
WB	-	World Bank
CRA	-	Credit Risk Assessment
QRF	-	Qualitative Risk Factor
CROS	-	Credit risk operating system
NPL	-	Non performing loan

ABSTRACT

Concerns about distressing credit activities and vulnerable credit risk management system have been climbing these years, from the United States troubled mortgage lending (2008) to the European debt crisis (2010). In the little country like Tanzania, small banks are also facing the big question of establishing a strong credit risk management framework. The purpose is to maximise their profits and to gain competitive advantage over their rivalries. This is where the research problem for this thesis arises.

The major objective of this research is to provide the investigated bank with an insight into the performance of credit risk management framework and the effectiveness of the credit risk management practices at the banks. The study aimed at finding out whether there was a policy and procedure involving in the credit risk management. Also, determining factors that hindered the effectiveness of credit risk management. Furthermore, determining impact of internal control on credit risk management enhanced by the employees' participation whether it contributed to the performance of an organisation.

Purposive sampling was used to select 16 employees from five different departments in Mbinga Community Bank. Head of departments and Officers was involved in Credit Risk Management. Data collection for this study employed different methods to collect data such as structured questionnaire, interview, observation and participation. Data were analysed by using descriptive statistical analysis. The study indicated that credit risk if not clearly designed could negatively impact on the performance of micro finance institution.

The study recommends organisation, to improve on, credit policies and procedure that are in place and train its employees on how to deal with credit risk management set by the organisation. Also the organisation should review internal control systems to make sure that they are effective in performing credit risk, and organisation should motivate employee for wages and allowances to ensure adherence and implementation on credit risk management.

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CHAPTER ONE

1.1 Introduction

This chapter assess the performance of Micro finance Institution on credit risk management. Credit risk management is one of the key functions of the microfinance institutions. Those micro finance institutions which analyse credit risk more consciously, protect, themselves from negative events, thus obtaining comparative advantage over competitors. That is why careful credit risk management is import for smooth cash flow and success of overall financial performance of micro finance institution.

1.2 Back ground to the problem.

The global economic depression that knocked almost all big economies throughout the world down in the past 5 years is still kept in many people minds. It was triggered by United States financial sector. One key reason for the collapse or nearly the collapse of the financial institution is the badly functioned subprime mortgage lending to companies or people with bad and unreliable credit. The process of risk management comprises fundamental steps of risk identification, risk analysis and assessment, risk audit monitoring and risk treatment or control, (Biker & Mets makers, 2005), (Timer 2001) Good risk management is not only a defensive mechanism, but also an offensive weapon for commercial bank and this is heavily dependent on the quality of leadership and governance. (Jorin 2009) notes that a recognised risk is less ‘risk’ than the identified risk. Risk is highly multifaceted, complex and often interlinked making it necessary to manage, rather than fear.

It is argued that the significance of the sound credit risk management in lending organisation is the popular type of risk that in both non financial and financial institution that must deal with. Credit risk occur when a debtor or borrower fail to fulfill his obligation to pay back the loans to the principal or lender. In banking business, it happens when payment can either delay, or it is not made at all, which can cause cash flow problems and affect bank liquidity, (Greening & Bratanovic 2009, p. 161). Hence credit risk management in bank basically involves its practices to manage or minimise risk exposure and occurrence. For commercial bank, lending activities form a critical part of its product and services. According to Greening &

(Bratanovic 2009) more than 70% of a bank balance sheet generally relates to this aspect of risk management is crucial to any bank success.

Commercial banks are the foundation of the payment system in many economies by playing an intermediary role between savers and borrowers. They further enhance financial system by ensuring that financial systems are stable and they are able to effectively facilitate financial transaction. There is need for commercial bank to adopt appropriate credit appraisal technique to minimise possibility of loan default. Since default of loan leads to adverse effects such as depositor losing their money, loss of confidence in the banking system, and financial instability. (Bank of Tanzania, 2006)

In a small country and in the economy like Tanzania, the financial sector is still in its development phase. Many small commercial banks have not been able to establish a firm risk management framework, particularly in credit risk management, in order to prevent unfavorable events. This is dangerous when Tanzania bank customer services are still in their infancy and banks revenue depends heavily on lending activities and credit growth is central to any banking organisation profit. (Kaijage et al 2008)

In Tanzania, there are a number of microfinance institutions playing an important role in mobilizing financial resources for investment by extending to various businesses and investors. Lending represents the heart of the banking industry and the loans as a dominant asset as they generate the largest share of operating income. Loans however expose the bank to the greatest level of risk. There are 45 financial institutions licensed in Tanzania at the end of 2012. More than 75% of these microfinance institutions in the country have been operating in the rural areas where access to formal financial institution was nearly impossible.

1.3 Study Area

This study was conducted at Mbinga Community Bank in Ruvuma. Mbinga community Bank Ltd (MCB) opened doors on 30th June 2003. The bank was licensed by central bank of Tanzania (BoT) as a regional unity bank with its head quarters in Mbinga town. Mbinga is located 1100 kilometers from Dar es Salaam the commercial city of Tanzania, to the south west of Tanzania, off great Lake Nyasa (Lake Malawi) bordering Malawi to the west and Mozambique to the southern. Mbinga district was famous in Arabica coffee production.

The bank was a Tanzanian bank owned by spectrum of shareholders comprising individuals, coffee curing company, NGOs, farmers groups, Sacco's and mbinga district council.

Vision

The vision of the bank is to be leading microfinance bank which will deliver high quality financial services for the development of Ruvuma region.

Mission

The mission of the bank is to provide financial services for the promotion of economic prosperity and self reliance among the rural and urban disadvantaged communities in Ruvuma region.

Core values

The core values of the organisation focus around the following attributes; integrity, customer services, innovation, leadership and teamwork.

1.4 Statement of the problem

Despite having stringent credit risk management policies and procedures, financial statement published quarterly by financial institutions as well as their annual reports; still show provision and charge off amounts are common in MFIs. This is a reflection of poor credit risk management and mitigation measures and also failure to recover from the collateral.

Lending is the most profitable business in the micro finance banks, but at the same time, it is highly risk. Loans are always accompanied by the credit risk arising out of the borrowers default in repaying the money. Hence banks should manage their loans business in a profitable and safe manner to avoid credit risk. (Mlabwa 2004).

Lack of effective credit review process is another problem. By credit review it means that credit officers should be able to check the data and conclusion supporting approved and disbursed credits. Audit department should be able to identify bad credit much earlier allowing further action to be taken. Many MFIs, particular Mbinga Community Bank face ineffective credit review process that has led to asset quality problems.

According to (Assenga 2008) in their study credit risk management on non performing loan (NPL) suggest that credit risk is inherent in the lending business of MFIs. This is why though credit risk is the oldest of all banking risk and still remain a challenge to date. The micro finance bank has no other way, but absorbing and managing the credit risk inherent in their business.

However to the knowledge of researcher, it is possible to conclude that although there have been a number of studies on credit risk management and related issues both in developed and developing countries, Tanzania, in particular, there is a few studies that exhaustively examine the credit risk management practice of Micro Finance Institution specially in Mbinga Community Bank in Tanzania. Thus this study is trying to fill the existing gap on performance of credit risk management in Tanzania.

1.5 Objective of the study;

1.5.1 General objectives

The general objective of the study is to assess the performance of microfinance Institution on credit risk management in Tanzania and to identify problems and ways to solve it.

1.5.2 Specific Objectives

The specific objectives of this study were to;

- Identify and examine policies and procedures involved in credit risk management.
- Assess factors hindering the effectiveness of credit risk management in microfinance institutions?
- Assess impact of internal control on credit risk management in microfinance institution.

1.6 Research Questions.

- What are policies and procedures used by the micro finance institution to examine credit risk management?
- What factors hinder the effectiveness of credit risk management in microfinance institution?
- How does internal control impact on credit risk management?

1.7 Significance of the study

The researcher believes that the results of this research will contribute to the following significance.

- This paper could be used as an initiation for those who are interested to conduct a detailed and comprehensive study regarding the performance of micro finance institution in credit risk management practice.
- It will enable a governing body, specifically the management, and the risk management department of the institution to be aware of about credit risk management and its effects on the growth of the institution income.

1.8 Limitation of the study

The researcher believed that the findings of this study would have been more productive if the study could be conducted on all micro finance institution in Tanzania. Due to small size of the sample, some of the findings of the research report might not truly represent the developments that have occurred in some Mbinga

Community Bank in the country. Thus, while some risk might be common to bank sector. The potential effect of such risk might vary from one micro finance bank to another.

1.9 Delimitation of the study

This study was conducted at Mbinga Community Bank, situated in Mbinga Ruvuma. The study involved credit departments, risk and compliance department, foreign exchange department, accounts and audit departments. The researcher concentrated much in the credit department and different views were obtained especially from the risk and compliance department dealing with all risks including credit risk management.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.0 Introduction

This chapter presents related literature on credit risk management. It covers on the sources and determinants of credit risk management, credit risk mitigations and techniques. Both theoretical and empirical literature is reviewed. The theoretical review provides the definition of key terms while the empirical review includes what has been done by other researchers in relation to the research topic.

2.1 Theoretical review

According to risk management frame work in Micro Finance Institution by GTZ (2000) risk is an integral part of financial services. When financial institution issues loans, there is risk of borrower default. When MFI collects deposits and lend them to other clients (conduct financial intermediation), they put client saving at risk. According to GTZ framework any institution that conduct cash transitions or makes investment risk the loss or those found. Development finance institution should neither avoid risk nor ignore risk. Like other institutions Micro Finance Institution (MFI) face risks that they must manage efficiently and effectively to be successful. If the micro finance institution does not manage its risk well, it is likely to fail to meet social and financial objectives. As (Nancy et al 2001) notes that when poorly managed risk begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organisation and funds begin to dry up. When funds dry up, MFI is not able to meet its social objectives of providing services to the poor and quickly goes up of business.(Nancy et al 2001) also notes that managing risk is a complex task for any financial organisation and increasingly important in a world when economic events and financial system are linked. Global financial institutions have emphasised risk management as an essential element of long term success. Rather than focusing on current or historical financial performance, management and regulators now focus on an organisation ability to identify and manage future risk as the best predictor of the long term success.

Information asymmetries are the main obstacles for micro finance institution to provide loans to clients. This finally results in credit risk which affects negatively the

performance of micro finance institution. (Nawai 2010).Therefore efficient credit risk management is required. According to (Silwal 2003) to minimise these problems financial institution usually requires business proposal, borrower past credit information and collateral before approving the loan.MFI also offer credit through group based lending method to mitigate agency problems, moral hazard and adverse selection and to replace the collateral requirements.

In group based lending, borrowers must form a group before applying for loans and they are also responsible to other loan members. If one number default the others will be responsible to pay the loan or they will be denied access for the next loans.

2.2 Categories of Credit Risk in Financial Institution

To gain better understanding on the nature of credit risk, it is necessary to introduce the types of credit risks involving in financial activities before any further discussion. Concerning the categorisation of credit risks, different authors have expressed various criteria. for example, As (Hannie 2003) cited in (Xiuzhu 2007) points out that the three main types of credit risk are of consumer risks, corporate risk and sovereign or country risk, while (Culp and Neves 1998) cited in (Xiuxhu 2007) consider realised default risk and resale risk to be the two types of credit risk. What is adopted here is part of the views from (Horcher 2005) cited in (Xiuzhu 2007) who defined six types of credit risks, including default risk, counterparty pre settlement risk counterparty settlement risk, legal risk, country or sovereign risk and concentration risk. However legal risk is more likely to be considered as independent or belonging to operational risks now days and concentration risk, together with adverse selection as well as moral hazard, it is more reasonably to be thought of as an important issue in managing credit risks rather than a type of the risk itself.

2.2.1 Default risk

According to (Horcher 2005) cited in (Xiuxhu 2007) traditional credit risk,it is related to the default on a payment especially lending or sales. And a likely hood of the default is called the probability of default when defaults occur the amount of risk may be as much as whole liability which can be recovered later depending on factors

like the creditors legal status. However later collections are generally difficult or even impossible in that huge outstanding obligation or losses are usually the reasons why organisation fail

2.2.2 Counterparty settlement risk

According to (Girardone and Molyneux 2006) cited in (Xiuzhu 2007) settlement risk is a risk typically faced in financial institution market and it refers to the situation where one part to a contract fail to pay money or deliver assets to another party at the settlement time, which can be associated with any timing differences in settlement. (Horcher 2005) cited in (Xiuchu 2007) points out that the risk is often related with foreign exchange trading where payment in different money Centers and not made simultaneously and volume are huge.

2.2.3 Country or sovereign risk

Country risk arises due to the impact of deteriorating foreign economic, social and political condition on overseas transaction and sovereign risk refers to the possibility that government may enforce their authority to declare debts to externals Lenders void or modify the movements of profits, interest and capital under some economic political pressure. (Casu, Girardone and Molyneux 2006) cited in (Xiuzhu 2007). (Horcher 2005) cited in (Xiuzhu 2007) establishes that countries and government have temporary or permanently imposed controls on capital prevented cross border payment suspended debts repayments etc. problems arise for issuers to fulfill obligations in such environment.

2.3 Managing risk in financial Institution

Risk management is a cornerstone of prudent financial institution practice. Undoubtedly all financial institutions in the present day volatile environment face a large number of risks namely credit risk, liquidity risk, foreign exchange risk, market risk and interest rate risk, among others risk which may threaten a financial institution survival and success.

In other words, financial institutions are business of risk (Kanwar 2005) for this reason efficient risk management absolutely is required. The purpose of financial

institution is to maximise revenue and to offer the most value of shareholders by offering variety of financial services and especially by administering risks. Recently many financial institutions have appointed senior managers to oversee formal risk management function and their objectives. (Thornton 2010).

2.3.1 Credit risk

According to risk management frame work for Micro Finance Institution of GTZ (2010) credit risk is the most frequently addressed risk for microfinance institutions, it is the risk to earning or capital due to barrowers late and nonpayment of loan obligations.

Credit risk encompasses both the loss of income resulting from microfinance constitution in ability to collect anticipated interest earning as well as the loss of principal resulting from loan default. Credit risk includes both transaction risk and portfolio risk.

A: Transaction risk: this is related to the individual borrower with which the MFI is transacting. A borrower may not be trustworthy and capable for repaying a loan which results into loss of loan. All loss of loan related to delinquency of individual client which can cause client migration, willful defaulting, business failure is called transaction risk.

B: Portfolio Risk: This is related to factors which can result in loss in a particular class or segment of portfolio. For example, a micro finance institution may loses portfolio with a particular trade due to some external reasons. These reasons could be political, communal and failure of an industry or trade.

2.4 Causes of credit risk in MFI

According to (Macaver and Ethimare n.d) the source of credit risk can be either at barrower level or financial (lender) level.

2.4.1 Causes of credit risk at borrower level

The causes of loan default at the borrower level include the following

- Failure of investment to generate sufficient income due to improper technical advice, inadequate support services, marketing risk or natural disaster.
- Diversification of loan from desired objective operation which makes it difficult to meet repayment commitment on time.
- Contingencies' at the borrower's house hold, such as sickness, accident or death (pure risk).
- Existence of liability towards informal lenders, which may get precedence over institutional lenders, leading to delinquency and default.
- Operation at very low level of subsistence, forcing additional income generated through loan supported activities to be appropriated for basic needs.

2.4.2 Causes of credit risk at financial institution (lender) level.

At the financial institution level, loan default may be due to any or a combination of the following: Defective procedures for loan appraisal, which could lead to financing of bad projects, thereby giving rise to delinquencies and default. (Antonio 2000).

Quality of loan officers, their mobility in the field, and their capacity to judge borrowers as well as incentive package available to them affect repayment.(Favero 1993). When loan officers are assessed more on the basis of compliance with lending target than with recovery performance, it could lead to bad loans. When responsibility for lending and recovery are vested with separate officials in a credit agency, recovery tend to decline.

Untimely loan disbursement and inappropriate repayment schedules, in addition when the procedure for repayment is bulky, borrowers tend to default. Inability or reluctance of lenders to enforce sanctions against conspicuous defaulters results in credit risk. When institution have limited contract with borrowers, default tend to increase. But when borrowers are in frequent contract and use several services of lenders default reduces. Absence of sound accounting and Management information system. (Creswell 2009)

2.5 Managing credit risk

Credit risk management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile.

It involves identification, measurements, monitoring and controlling risk to ensure that the individual who take or manage credit risk clearly understands it. The organisation risk exposure is within the limits established by Board of Directors , risk taking decisions are in line with the business strategy and objectives set by BOD, the expected pay off compensate for the risk taken, risk taking decisions are explicit and clear, sufficient capital as the buffer available to take risk (Nagarajan 2001)

The board is responsible for ensuring that a formal risk assessment is under taken at least annually for the purpose of making its public statement, including internal control. The board should acknowledge in this statement, its responsibility for the risk management process and for reviewing its effectiveness.

Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day to day activities of the institution. (Thornton 2010).

2.5.1 Principle of credit risk management

To review the general principle of credit risk management it can provide a clear picture on how financial institution includes MFI carry out their credit risk management. According the (Basel 2000) the sound practices of financial institution on credit risk management should cover the following four areas of credit risk management principle:

A: Establishing an appropriate credit risk management.

To establish an appropriate credit risk environment it mainly depends on a clear identification of credit risk and the development of a comprehensive credit risk strategy as well as policies. To MFI, the identification of existing and potential credit risks inherent in product they offer and the activities they engage in its own it is a

basis for an effective credit risk management. This requires a careful understanding of both the credit risk characteristics and their credit granting activities, especially complicated or newly developed ones. Besides the design of objectives, credit risk strategies and policies that guide all credit granting activities is also the cornerstone in MFI credit risk management process. (Basel committee 1999).

B: Operating under a sound credit Granting process.

A sound credit granting process requires the establishment of a well defined credit granting criteria, as well as credit exposure limits in order to assess the credit worthiness of the obligors and to screen out the preferred one. MFI credit criteria are designed to shape type and characteristics of its preferred obligors.

C: Maintaining appropriate credit Administration.

Credit administration can play a vital role in the success of microfinance institution, since it is influential in building and maintaining a safe credit environment and usually it saves the institution from the lending sins.

D: Ensuring adequate control over credit risk.

The means of guaranteeing adequate control over credit risk in MFI lay in the establishment of different kinds of credit reviews. Regular credit reviews can verify the accordance between granted credits and the credit policies, and independent judgments can be provided on the asset qualities.

2.5.2 The goal of credit Risk Management.

The goal of credit risk management as presented by (Basel 2000) is to maximise financial institution risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters.

Consistent with principles of managing portfolio, it is requested that both the credit risk arising from individual, creditors or transaction and the risk of the entire portfolio should be managed, and the relationship between credit risk and others must be equally considered.

2.6 Method to Mitigate Credit Risk.

According to (Zoltan et al n.d) the following are some of the methods that lenders can mitigate credit risk. (Pavla Vodova n.d) also noted the following as a means of credit risk mitigation mechanisms.

- Risk based pricing: Lenders generally charge a higher interest rate to borrowers who are more likely to default, a practice called risk based pricing. Lenders consider factors relating to the loan, such as loan purpose, credit rating and loan to value ratio and estimate the effect on yield.
- Covenants: lenders may write stipulations on the borrower called covenants into loan agreements.
- Periodically report on its financial condition.
- Refrain from borrowing further or other specific voluntary action that negatively affects the company's financial position.
- Repay the loan in full at the lender's request in certain events such as changes in the borrower's debt to equity ratio or interest coverage ratio.
- Tightening: Lenders can reduce credit risk by reducing the amount of credit extended, either in total or to certain borrowers, for example, a distributor selling its product to a troubled retailer may attempt to lessen credit risk by reducing payment terms from net 30 to net 15.
- Diversification: Lenders to a small number (or kind of borrowers) face a high degree of unsystematic credit risk called concentration risk. Lenders reduce this risk by diversifying the borrower pool.

2.7 Collateral as a means of Credit Risk Mitigation in MFI.

Collateral is a risk reduction tool, which like many other such tools mitigate risk by reducing credit exposure. The effect of collateralisation is to substitute the credit risk of the issuer of the collateral for that of the counterparty to the transaction.

Collateral reduces credit risk, but it gives rise to other forms of risk including legal, operational and concentration risk.

In lending agreement, collateral is the borrower pledge of specific property to a lender to secure the repayment of the loan. (Condolff 2006) and (Anderson 2010) also note that the `collateral serves as the protection for lender against a borrower default, that is any borrower failing to pay principal and interest under the terms of a loan obligation. If a borrower does default on a loan (due to insolvency or other events), that borrower forfeits (gives up) the property pledged as collateral and the lender then becomes the owner of the collateral.

Collateral, especially within the MFI, may traditionally refer to secured lending (also are known as asset based lending). More recently, complex collateralisations arrangement are used to secure trade transactions.

2.7.1 Valuation of Collateral

The valuation of collateral provided by the credit applicant is an essential element in the credit approval process, thus it has an impact on the overall assessment of the credit involved in a possible exposure (Cresswel 2009). The main features of a collateralised credit is not only the borrower personal credit standing, which basically determines the probability of default (PD), but the collateral which the lender can realise in case the customer default and which thus determines the MFI loss

2.8 Managing credit Risk using financial Ratios

Assessing financial institution management of credit risk reveals information about sustainability of operations. The analysis involves examining financial ratios related to loan quality. Future loss from loans that are not repaid is never certain. However, sound institutions have sufficient capital reserves for potential losses (Hubber 2010).

According to (Demerjan 2007) the following are the common financial ratios calculated to measure the credit risk of financial institution including micro finance institutions. These are portfolio at risk and repayment rate ratios.

Although credit risk is inherent to all loans of the MFI, It materialised the loans which start showing over dues. An amount is called overdue, if it is not received by the MFI on its schedule time.

Every loan that the MFI provides have fixed schedule for repayment .This is called repayment schedule, which provides the schedule of repayment and act as the reference point for the MFI to estimate there over dues.

At the time of loan disbursement every client is given repayment schedule which shows the amount to be paid in each installment and the date of payment. If the amount is not received on or before the schedule date it is called overdue.

If any loan has any amount overdue, it is termed as delinquent loan or a case of delinquency (Demerjan 2007). The MFI tries to have an objectives view of their credit risk and want to measure the extent of credit risk, which is the risk in their portfolio.

There are various indicators which help in measuring the credit risk profile of the MFI. These indicators portfolio at risk or common known as PAR is considered to be the most effective and is now a very common indicator across the MFIs. Apart from PAR, repayment rate is another ratio which also provides information about the portfolio quality of the MFI(Demerjan 2007)

PAR, Portfolio at risk tries to measure the amount of loan outstanding that the MFI, stands to lose in case an overdue client does not pay a single installment from the day of calculation PAR.PAR is the proportion of loan with overdue client to the total loan outstanding of the organisation.

PAR= (Loan outstanding on overdue loans/Total loan outstanding of the MFI)*100

Repayment rate = (repayment rate on the other hand is the ratio of the amount received by the organization against the total amount due.

Repayment rate= (Total principal collection during the period-prepayment)/Total amount due for the period)*100

Prepayment: if any amount have to be deducted from the collection as this amount was not due for the period. Prepayment is the principal amount paid by client before it was due. As mentioned earlier, all these ratios in the MFI and financial institution lay maximum emphasis on PAR and consider it as the best indicator for risk. This is

because PAR is forward looking ratios provides an estimate of the total loss that the MFI is likely to make should be risk client default. While repayment rate only provide information of current loss and indicate the past performance. Repayment rate is not able to capture the future risk.

2.9 Components of Credit Risk Management

According to the risk Management guidelines for commercial banks and other financial institutions in Pakistan, A credit risk Management frame work for microfinance institutions consist of Board of Directors, Senior management oversight, Organisation structure and system for procedures and monitoring GTZ (1999 and 2000) Principle for management of credit risk Basel committee for credit exposure (Irish financial services authority 2005), guide lines on credit risk management for financial institutions prepared by Eastern Caribbean Central bank (2009) appraisal guide for microfinance institutions.

(Isern et al, 2008) in their writing state that typical credit risk management framework in a financial institution may be broadly categorised into following main components

- Board and Senior Management oversight
- Organizational structure
- Systems and procedures for identification, acceptance, measurements, monitoring and control risk.

2.9.1 Board and Senior Management oversight.

It is the overall responsibility of the Board to improve institution credit risk strategy and significant policies relating to credit risk and its management which should be based on the institution overall business strategy. To keep it current, the overall strategy has to be reviewed by the board, preferably annually. (Dawson 2002)

The responsibilities of the Board with regard to credit risk Management shall include:

- Explain the institution overall risk tolerance in relation to credit risk.
- Ensure that institution overall credit risk exposure is maintained at prudent levels and consistent with the available capital.
- Ensure that top management as well as individual responsible for credit risk Management possess sound expertise and knowledge to accomplish the risk management function.
- Ensure that the institution implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk.
- Ensure that appropriate plans and procedure for credit risk management are in place.

2.9.2 Responsibilities Senior Management.

The senior management in the institutions should develop and establish credit administration procedure as a part of overall credit risk mgt framework and get those approved from the board. Enrique and (Pantoja (2002) say that such policies and procedures shall provide guidance to the staff on various types of lending including cooperate, SME, customer and agriculture.

At minimum the policy should include

- Details and formalised credit evaluation/appraisal process.
- Credit approval authority at various hierarchy levels including authority for approving exceptions.
- Risk identification, Measurement, Monitoring and control.
- Risk acceptance criteria.
- Credit origination and credit administration and loan documentation procedures.
- Roles, and Responsibilities of units/staff involved in origination and Management of credit
- .Guidelines on management of problem loans.

2.9.3 Organisational structure.

To maintain the MFI overall credit risk exposure within the parameters set by the board of directors, a sound credit risk management structure is required.

While the MFI may choose a different structure. (Laurentis 2009) opines that it is important that such structure should be commensurate with institution size, complexity and diversification of its activities. (Anderson 2010)

It must facilitate effective credit risk management oversight and proper execution of credit risk management and control process.

Each MFI, depending upon its size, it should constitute a credit risk Management committee (CRMC) ideally comprising of head of credit risk. Management department, credit department and treasury. This committee reports to institutor of risk management committee. (Condolff 2006) this empowered to oversee credit risk taking activities and overall credit risk Management function.

The CRMC should be mainly responsible for:

- The implementation of the credit risk policy/strategy approved by the board;
- Monitor credit risk and ensure compliance with limits approved by the board;
- Recommended to the Board, for its approval, clear policies on standard for representation of credit proposal financial covenants, relating standard and benchmark;
- Dead delegation of credit approving powers, prudential limits on large credit exposure, standard for loans collateral, portfolio Management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance. (Cohen et al 2000).

2.9.4 Systems and procedures for Identification, monitoring and Control risk.

Microfinance institutions must operate within a sound and well defined criteria for new credit as well and the expansion of existing credits. (Creswell 2009) that credits should be extended within the target market and lending strategy of the institution. Before allowing a credit facility, the MFI must make an assessment of risk profile of the customer/transaction.(Cohen et al 2000)

This may include

- Credit assessment of the borrower industry and micro economic factors.
- The purpose of credit and source of repayment.
- The track reward/repayment history of borrower.
- Assess/Evaluate the repayment capacity of borrower.
- The proposed terms and conditions and covenants, and
- Adequacy and enforceability of collaterals

2.9.5 Credit administration

Ongoing administration of the credit portfolio is an essential part of the credit process. (Silwal 2003) adds that, Credit administration function is basically a back office activity that support and control extension and maintenance credit.

A typical credit administration unit performs the following functions:

- Documentation: it is responsibility of credit administration to ensure completeness of administration (Loan agreement, guarantees, transfer of title of collaterals) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt(Zinman 2007)
- Credit Disbursement: The credit administration has proper approval before entering facility limits into computer systems. Disbursements should be effected only after completion of covenants, and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent country.
- Credit monitoring: After the loan is approved and draw down allowed, the loan should be continuously watched over. (Kereta 2007) These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.
- Loan Repayment: The obligor should be communicated ahead of time and when the principal/mark up installment becomes due. (Zinman 2007) notes that any exceptions such as nonpayment or late payment should be tagged

and communicated to the Management. Proper records and updates should also be made after receipt.

- Maintenance of credit files: Institution should device procedural guidelines and standards for maintenance of credit files. (Santamero 1997) observes that the credit files not only include all correspondence with the borrower but it should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance.
- Collateral and security Documents: the financial institution should ensure that all security documents are kept in a fireproof safe under dual control. (Santamero 1997) Registers for documents should be maintained to keep track of their movements-procedure should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical check on security documents should be conducted on a regular basis. (Habibu & Ahmed 2009)

2.9.6 Credit Risk Monitoring and Control.

Credit risk monitoring refers to incessant monitoring of individual credits inclusive of off balance sheet exposures to obligors, as well as overall credit portfolio on day to day basis and take remedial measures as and when any deterioration occurs. (Idemobi 2011) such a system would enable an institution to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions. The overall risk profile is within limits established by Management and compliance of regulatory, limits. (Creswell 2009) Establishing an efficient and effective credit monitoring system would help senior Management to monitor the overall quality of the total credit portfolio and its trends. Consequently the Management could fine or reassess its credit strategy/policy accordingly before encountering any major setback. (Cohen et al 2000)

The MFI credit policy should explicitly provide procedural guidelines relating to credit risk monitoring.

At the minimum, it should lay down procedure relating to:

- The roles and responsibilities of individuals responsible for credit risk monitoring;

- The assessment procedures and analysis technique (for individual loans and overall Portfolio).
- The frequency of monitoring;
- The periodic examination of collaterals and loans covenants;
- The frequency of site visits, and
- The identification of any deterioration in any loan.

2.9.7 Credit Analysis

Credit analysis is geared towards one decision: does the financial institution grant the loan? (Morrison 2000) maintains that the purpose of credit analysis is to generate profitable loan that do not expose the lender to excessive amount of risk. The reason for acceptance or reject decision should be clearly documented and the decision should be in accordance with the MFI stated loan policy. (Condolff 2006) observes that Criteria used must not be discriminatory that is to say the determinants of the decision cannot be race, gender, location, ethnicity or religious persuasion.

(Condolff 2006) adds that, In the long run it will cost the lender much more to handle a failed loan than to incorrectly turn down a loan that would not have failed. This is true because lending has asymmetric out comes. Distribution of returns on loans exhibits negative skewness.

Lowering credit quality tends to increase the negative skewness although if the risk is priced this may also increase the average rates of return on the loan portfolio. Regulators impose quality standards on lender to help ensure that they do not take on too much risk in attempting to increase the average return on the loan portfolio.

The MFI loan policies include the desired portfolio of loan by category and include minimum credit standard such as collateral requirements and minimum ration. Other provisions include limits for certain loan offices positions, standard for grading loan, requirements for monitoring existing loan, policies on inside loan and the documentation required to evaluate a loan application. (Nusselder 2003)

2.10 Microfinance institution in Tanzania

It is believed that the provision of micro credit to poor households would increase their assets and income. As a result, microfinance credit is considered as one of the methods of alleviating poverty. Since in mid 1990s, many non governmental organisations (NGO) in Tanzania have started providing micro-credit to poor households for income generating activities Michael (2006). Moreover, the development bank of Tanzania, in collaboration with the ministry of trade has launched a microfinance lending programme. Since 1994, recognising the importance of microfinance facility, the present government issued a proclamation that laid down the framework for licensing and supervision of the business of the microfinance institution (MFI) in July 1996.

The objectives of the proclamation were to:

- (i) Provide a legal framework that brings monetary and financial policies;
- (ii) Provide legal framework for the promotion of the MFI, the proclamation allows the MFI to undertake both financial and non financial activities.

(Michael 2006) adds that, the increasing and supervision of the MFI enhanced the status of the MFI. This authorised them to, among many other things, legally accept deposits from general public (hence diversity of their source of funds), draw and accept deposits, and manage funds for microfinance business.

2.11 Empirical Literature Review

Within the last few years a number of studies have provided the discipline into the practice of risk Management and other issues of microfinance institution. An insight of related studies as established in some of the following research project;

(Mwacha 2008) conducted study on credit risk management on commercial bank and it was found that some organisations have the problem of employees who have skills and ability to work in proper manner on the day to day work. The study recommends management should be able to employ qualified people who have skills and competent and can work in properly.

(Bruet 2001) in their study of financial performance monitoring, explains that there was negative impact on the internal control in the micro finance institution. This study notes that micro finance institution provide positive impact especially internal control on credit risk in order to manage some risk especially credit risk management.

(Assenga 2008) in study on credit risk management on non performing loan (NPL) on commercial bank found that many organisation probably micro finance institutions have not conduct training in the organisation either short course or long course, Due to that, employees can work for the long period without any training thus resulting in employees lacking new knowledge or techniques to avoid or decrease credit risks management.

(Samwel 2006) conduct the study on impact of micro finance institutions it was found that effectiveness of credit risk management depends on the organization how it pay employees. This means that if the organisation pays good wages and other benefits it can decrease credit risk in the management.

(Paul et al 2001) in their study of viewing microfinance as a social risk Management instrument report that there should be efficient and equitable risk Management for microfinance institutions through micro insurance since micro insurance has positive impact on effective credit risk Management. The study also notes that it is clear that micro insurance may be an acceptable means of managing some forms of risks but not in all micro finance institutions.

(Peterson and Bohman 2008) in the study of credit risk Management system of a commercial bank in Tanzania found that the financial institution well documented credit risk Management policies and procedure. The policies and procedures elaborate the products offered and all activities play an important role to manage credit risk. The institution well organised credit manual that documents and elaborates the strategies for managing credit risk. Also the part of effective credit risk management and they have to formulate in compliance with the institution credit

policy. Strategies for granting credits also should focus on whom, how and what should be done at the branch and corporate division levels while assessing borrowers.

However to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on credit risk management and related issues both in developed and developing countries, Tanzania, in particular, there is a few studies that exhaustively examine the credit risk management practice of micro finance institution specially in Tanzania.

As a result this study was designed to fill the aforementioned gaps and provide concluding recommends having the main objectives of analysing and examining the performance of sample (MCB) micro finance institution in credit risk management in Tanzania.

2.12 Conceptual Framework.

According the (Smyth 2004),define conceptual frame work are the structured from a set of broad ideas and theories that help a researcher to properly identify the problems they are looking at the frame their questions and find suitable literature. Most of the academic studies use a conceptual frame work at the outset because it helps the researcher to clarify his research questions and aims. The researcher explains the conceptual frame work, theoretical and conceptual frame work of the research.

The researcher conceptualised the credit risk management as a function of (credit policy & procedure +effectiveness +internal control)

$CRM=f(CP \&P +E +IC).$

CP & P is an independent variable (IV)

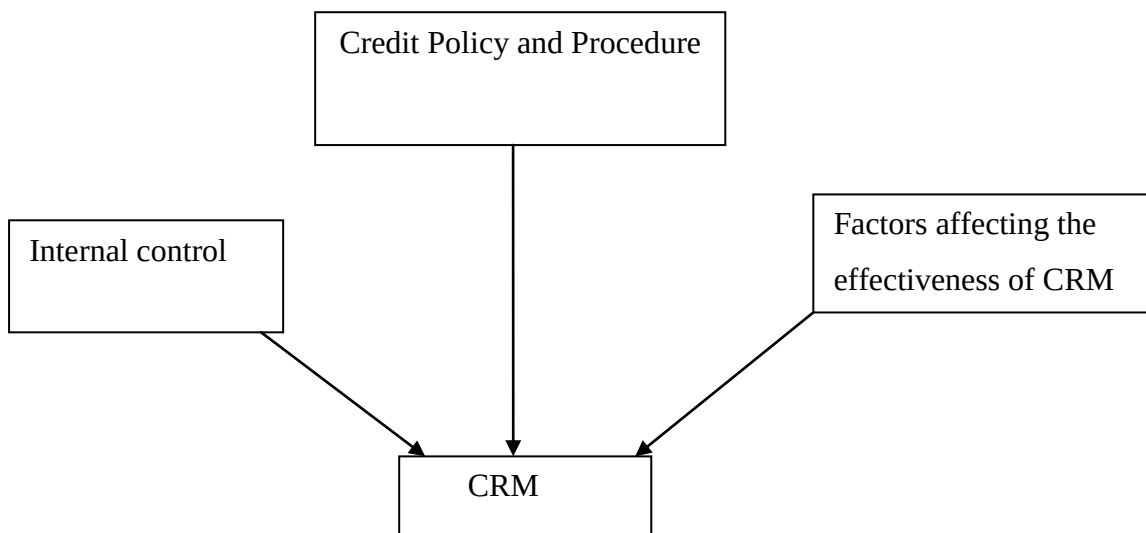
E is an independent variable (IV)

IC is an independent variable (IV)

Performance is a Dependent variable (DV)

Credit risk model

Figure 1.1 Conceptual frame work



Key

→ Direct relationship

Source:Mbinga Community Bank 2013.

Figure 1.1 indicates the relationship between the independent and dependent variables which affect the performance of credit risk management as discussed below.

2.12.1 Credit policy and procedure

Is one of the factors that researcher used to assess the performance of credit risk management in the micro finance institution. As this current faced most MFIs in the country were misappropriation of policy and procedure on performing credit risk management in the organisation. Due to this most MFIs were financially inefficient and failed to manage credit risk required by organisation, hence MFIs objectives were not achieved. Approach would address as much as possible the challenges faced

credit risk management in the micro finance institution. The main challenge Credit policies and procedures are credit officers to control granting credit facilities. Set standards and parameters to guide bank officers who grant loans and manage the credit risk.

Credit policy is a guide to successful credit administration and benefits must be weighed against the cost to ensure the benefits are worth the effort of administering the credit. The essence of credit policy and procedure is to maximise the value of a firm.

2.12.2 Factors affecting credit risk management.

Financial institution have faced number of difficulties over the years for the multitude of reasons, working environment is among the factors that hinder the effectiveness of credit risk management, when the organisation have no conducive environment can discourage the employee to work in the organization. Also organisation should be responsible for employee benefit, this is among challenge facing Mbinga Community Bank. It is important for the organisation to prepare scheme of payment which can help the employee to stay in the organisation for the long period of time. Working Experience is another challenge facing MCB, in order to control this challenges the organization should be able to prepare suitable environment for employees to work, paying employees good salary and other benefits in order to decrease the movement of employee's turnover. All the above are factors that hinder the effectiveness of credit risk management in the micro finance institution.

2.12.3 Internal control

(Mill champ 2002) defines internal control as, "The whole system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policy, safeguard the assets and secure as far as possible the completeness and accuracy of the records".

The challenges which faced MCB is lack of internal control, that there is shortage of internal control in the day to day activity. Among the source of credit risk in Mbinga Community Bank was lack of commitment in the internal control, like shortage of employees, in this department there was only two employee chief internal auditors and one staff. For the organisation to improve on credit risk management it was important for management of MCB to strengthen the audit department by employing more staff.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology and procedures used in carrying out this research. The chapter presents research approach, area of study, study population, unit of analysis, variables and measurements, sample size and sampling techniques. It also provides information about data collection methods as well as procedure and processes which will be followed during data collection.

3.2 Research design.

The researcher used a case study design in conducting this study due to the facts that, the study was carried out in a limited time and funds, hence, only a single organization was considered. Due to these, the design chosen earlier was appropriate because it was less expensive compared to other methods of data collection as well as it was flexible in terms of data collection methods to be used as it accommodates all data collection instruments such as interview, questionnaire, observation and documentation.

3.3 Study population

The targeted population were staff employed at Mbinga Community Bank.

3.3.1 Target Population

This depended on the number of employees working on those particular areas of the study, especially those working in the selected departments. The study comprises of the total population of (31) respondents from selected departments. It involved members from different sections of the organisation, including:-

- Credit department.
- Risk and compliance department
- Foreign exchange department
- Audit department
- Informational technology department

3.4 Sample size

Sample can be defined as a selected unit from the population or universe or a small part of the larger population. (Zinman 2006) In this study, the task of credit risk management does not belong to one department or section within the organisation, thus the sample includes all respondents from credit department (7), two (2) respondents from audit department, four (4) respondents from risk and compliance department, two (2) from foreign exchange department and one (1) respondent from information technology. Selected respondents per section vary in number due to the varying numbers of staff involved in the working place.

3.5 Sampling techniques

Sampling procedures refers to a definite plan for obtaining a sample from the sampling frame. (Kothari 2008) the purposive/Judgmental sampling technique and simple random technique was used for the purpose of obtaining the list of names of the people to be interviewed.

Judgmental sampling

This type of sampling was applied by the researcher in order for him to be able to obtain list of heads of unit to be interviewed. In this method the researcher had appropriate chance to select a sample on the basis of his own knowledge of population, its element and the nature of the study. The method was applied, because all respondents were considered capable of providing relevant information. Through this approach, a researcher interviewed most of the staffs who were directly concerned with credit department.

Simple random sampling

This type of sampling was used by the researcher in order to enable him to obtain a representative sample because under this type of sampling all elements in a given population had an equal and independent chance of being selected in a particular sample to be chosen. The researcher prepared a list of employees which had a total number of 31 employees in which after every 2 names of the employees from the list

was selected to be a sample for the interview in which a sample had 16 employees participant.

3.6 Data collection methods

Both primary and secondary data were collected. Primary data was obtained through interview and observation while secondary data was obtained by reading extensively various documents and other literature available.

3.6.1 Primary data collection method:

Primary data refers to the data which is primarily collected from the primary sources and thus for the first time is used for purpose as collected. Under this method the researcher used the following tools for data collection:-

Interview

Conversation interview and unstructured interview was conducted in the course of doing day-to day activities. The researcher asked several questions for the purpose of obtaining information concerning the credit over the credit risk management. This method involved discussions with the heads of departments such as credit department, risk and compliance department, foreign exchange department and staff from various departments.

Observation and participation

Observation is the primary techniques for collecting data on non-verbal behaviours. It helped to collect information concerning attitudes, perception and behaviour of respondents in the area. In this study an observation technique was applied where a researcher attended physically in credit section. Therefore it helped the researcher to observe activities involved in the credit department.

Questionnaire

The researcher use both open ended and closed ended questionnaires which was be distributed to various staffs and officers within the organisation which the researcher

found appropriate to obtain required relevant information. The researcher decided to use this method because it saved both time and money.

3.6.2 Secondary data collection method

Secondary data are data which are not collected from their primary source; these were extracted through reviewing various documents such as:

- Published audited accounts and report from 2006 to 2012
- Un audited accounts and report for 2013
- MCB quarterly reports
- MCB websites
- % year financial projection and budget.

3.7 Data Analysis and Presentation

The data and information collected were qualitative and quantitative data. Qualitative data were analyzed through content analysis and presented through narration. Quantitative data were coded in their nature and the response from all questionnaire copies entered into a computer using Statistical Package for Social Sciences (SPSS) software. Quantitative data analysis is any data that is summarized in numerical form such as statistics and percentages. Descriptive statistical analysis was used to show the particular effect of variables using frequencies, percentage distributions and tables.

CHAPTER FOUR

RESEARCH FINDINGS AND ANALYSIS

4.1 Introduction

This chapter describes the findings and analysis of the study that a researcher has come across throughout the time of the research at MCB, relating to the assessment of performance of micro finance institution on credit risk management. In analysing the data, research questions were considered and the researcher studied different documents in the organisation as well as conducted some interviews with relevant officials when gathering data. Therefore the findings show what actually was done by the organisation to ensure that their objectives are realised.

4.2 Demographic Characteristics

4.2.1 Sex of Respondent

The respondent was asked to indicate their sex. Their response is indicated in Table 4.1

Table 4.1: respondent by sex

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Male	10	62.5	62.5	62.5
Female	6	37.5	37.5	100.0
Total	16	100.0	100.0	

Source. Research data 2014

4.2.2 Age bracket of Respondent

In order to assess the responsibility of respondents, the respondent was requested to give his/her age and the response was as follows;

Table 4.2: Age of respondent

	frequency	percentage	Cumulative percentage
valid <25	2	12.5	12.5
25-35	11	68.8	81.3
36-60	3	18.7	100.0
total	16	100.0	

Source: research data 2014

Finding in the Table 4.2 indicates that 68.8% of the respondents were between the age of 25 and 35 years, 18.7% respondent was between 36 and 60 years, and 12.5% were the less than 25% years. This implies that almost all respondents their youth portfolio. Hence they can easily understand credit risk management, but still lack enough experience to manage the loan.

4.2.3 Education information

In order to be sure on the education of respondent, the respondents were requested, to give their level of education and their responses is as shown in Table 4.3

Table 4.3: Level of education of respondents.

		Frequency	Percent	Valid Percent	Cumulative Percent
	Masters	2	12.5	12.5	12.5
	Degree	8	50	50	62.5
Valid	Diploma	4	25	25	87.5
	Certificate	2	12.5	12.5	100
	Total	16	100	100	

Source: Research data 2014

Finding in the table indicates that a small number of respondent were highly educated that was shown by the 12.5% of respondents who had master degree, however 50% of the respondents were degree holders, while 18.75% were diploma and certificate holders. By virtue of their education structure, the researcher might assume that they know what the organisation performance was and hindrance to effective performance.

4.2.4 Working Experience of Respondents.

Table 4.4 Working experience of respondents.

N0 of years		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-3	7	43.75	43.75	43.75
	4-6	6	37.5	37.5	81.25
	7-10	3	18.75	100	100
	Total	16	100	100	

Source: Research data 2014

As shown in Table 4.4 on the employees who responded on this particular question showed the working experience on the credit risk. 43.75% of the respondents was less than three years, 37.5% had four to six years working experience in the organisation and remaining 18.75% had more than seven years on the credit risk department, foreign exchange department and risk and compliance department.

4.2.5 Training of the respondents.

It was also found that 12 (75%) of the respondent had not received any training on the credit risk management from 2011 up to January 2014. While 4 (25%) of the respondent could get training, as shown in the Table 4.5. According to results given out through this study, the level of training was inadequate.

Table 4.5 Training respondents.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	4	25	25	25
NO	12	75	75	100.0
Total	16	100.0	100.0	

Source: research data 2014

4.3 Policies and procedures on credit risk management.

The first objective of the study was to identify and examine policies and procedure in the credit risk management.

In answering the first objective, the respondents were asked to confirm whether there was credit risk policies and procedure in identifying and examining credit risk management. The responses were in Table 4.6

Table 4.6: Awareness of policy and procedure on CRM.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	14	87.5	87.5	87.5
NO	2	12.5	12.5	100.0
Total	16	100.0	100.0	

Source: Research data 2014

Findings in Table 4.6 portray that 87.5% of respondents strongly agreed that there were credit risk policies and procedures in MCB. Minority 12.5%disagree on credit policy and procedures. The researcher could therefore conclude that there were credit risk management policies and procedures in Mbinga Community Bank due to large number of percentages that agreed.

4.3.1 Implementation of credit risk on policies and procedure

The management of MCB in the recently years had not performed well in the credit risk management. Thus profit from loan for the period of 2009 up to 2011 decreased on credit risk management. From that management reviewed and implemented the significant change that was needed to design and implement new system, risk models, policies, procedures and process to manage it.

Table 4.7: Implementing credit risk management policies and procedures.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	7	43.75	43.75	43.75
NO	9	56.25	56.25	100.0
Total	16	100.0	100.0	

Source: primary data

From the findings in Table 4.7, 56.25% of the respondents disagreed that credit policies and procedures were fully implemented. Hence this may imply that the policies and procedure do not meet the demand of the customers, thus failing to answer their constant problems of failing to repay loan on timely.

4.4 Factors hindering effectiveness of CRM.

The second objective was to assess the factors that hindered effectiveness of credit risk management, the factors involved lack of training to the employees who worked on credit department as shown in Table 4.8. As shown in the table 4.5 of MCB there was inadequate training within the organisation that caused ineffectiveness of the organization. Due to inadequate training in MCB this cause Poor involvement of employees in training process.It was also revealed that criteria for trainee selection

were not clear known and employee were not given chance to determine the kind of training they actually needed.

Table 4.8: Respondent knowledge on factors hindered effectiveness on CRM

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	13	81.25	81.25	81.25
NO	3	18.75	18.75	100.0
Total	16	100.0	100.0	

Source: Research data 2014

The study intended to find out first the factors hindered effectiveness of respondents on the credit risk management. Respondents were asked whether they were aware of factors that hindered the effectiveness. It was found that 84% of the respondents were aware while the remaining 16% were not aware. This implies that most of the employees understand the factors that hinder effectiveness of credit risk management in the micro finance institution.

The analysis indicates that majority of the respondent 84% agreed that there were factors that hindered effectiveness on credit risk management. This implies that all respondents are of the view that in order for the bank to reduce the factors that hinder the effectiveness of credit risk management.

4.4.1 Working Environment

It was found that (68.75%) of respondents said that working environment was not conducive. This was because many work facilities were not in place. Also (31.25%) of respondents agree that environment especially employees who had worked and stayed for more than five years were in favour of then working environment.

Table 4.9 showing working environment

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	5	31.25	31.25	31.25
NO	11	68.75	68.75	100.0
Total	16	100.0	100.0	

Source: Research data 2014

4.4.2 Working Experience

From the Table 4.4 findings show that most of the respondents 43.75% had less than three years experience in the credit risk department, also 37.5% of the respondents had more than five years. And the remaining 18.75% had more than ten years working experience. Due to that it was possible for the organisation to create loss due to lack of effectiveness on the credit risk management. Lack of experience was another factor that hindered the effectiveness of credit risk

4.4.3 Employee benefits (Allowances)

From Table 4.10 finding shows that shows the benefit received from employer (62.5%) did not agree to have received benefit from employers, while (37.5%) of the respondents agreed that they were satisfied with the allowances received from the organization.

Table 4.10 Employee benefits.

	Frequency	Percent	Valid Percent	Cumulative Percent
YES	6	37.5	37.5	37.5
Valid NO	10	62.5	62.5	100.0
Total	16	100.0	100.0	

Source: Research data 2014

4.5 Impact of internal control on credit risk management

The third objective of the study was on the impact of internal control on credit risk management. The purpose was to find out awareness of respondents on the credit risk management in Mbinga Community Bank. Respondents were asked by using questionnaires, whether they were, aware on the credit risk management. From the table 4.11 finding shows that the 75% of the respondent did not agree that there was adequate internal control in Mbinga Community Bank, while 25% of the respondents agreed that there was internal control in the organisation. This implies that most of employees' staff are aware on internal control of the organisation.

Table 4.11 shows respondent awareness on internal control

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid YES	12	75	75	75
NO	4	25	25	100.0
Total	16	100.0	100.0	

Source: Research data.

The respondents agreed that there was inadequate internal control in the organisation which resulted into;

- Failure to document the process for continuous monitoring, thus leading to incapability to ensure internal control is in place and continue to operate effectively to mitigate continued credit risk such as fraud/theft.
- Failure to periodically review on the use of sensitive information included in credit risk management operating system such as CROS in MCB.
- Flaws in separation of duties personnel authorised to approve fund may be involved in the payment of loan and.
- Failure to reconcile records such as payment receipt against source of document from the clients.

CHAPTER FIVE

DISCUSSION OF FINDINGS.

5.1 Introduction

This chapter discusses findings obtained during the field study on the topic which assesses the performance of microfinance institution on credit risk management.

5.2 Discussion of findings

5.2.1 Identifying and Examining policies and Procedures in place for credit risk management.

Credit policies and procedures are set of objectives, standards and parameters to guide bank officers who grant loans and manage the loan portfolio. Thus, they are procedures, guidelines and rules designed to minimize costs associated with credit while maximising the benefit from it (Ahimbishwe, 2002). The main objective of credit policy and procedure is to have an optimal investment in debtors that minimises costs while maximizing benefits hence ensuring profitability and sustainability of microfinance institutions.

With respect to this objective, most respondents (87.5%) agreed that there was policy and procedure concerning credit risk management in Mbinga Community Bank. This implies that most officers know well policy and procedure regarding credit risk management in the financial institution. The findings are in line with those of (Samwel 2006) on the thesis of effectiveness of credit risk management in commercial bank in Tanzania showed that the organization has credit policies and procedures in place like use of collateral security against loans but the challenge was the adherence on credit risk management especially for credit officers.

The essence of credit policy and procedure is to maximise the value of a firm to reduce underperforming loans and untimely payments can be minimised through proper administration of the credit policy and procedure. All this policy and procedure can be done when the organisation can provide incentive of training to the employee in the credit risk management. As shown in the Table 4.5 that 75% of the respondent disagree on organization can not conduct training in the organization, the finding are in line with those of (Mwacha 2008) on credit risk management on micro

finance institution who found that some organisation have ineffective staff training function due to insufficient budget allocated for training within the organisation.

5.2.2 Factors hindering the effectiveness of credit risk management.

In this objective most of the respondents 81.25% agree that there were factors that hinder the effectiveness of the credit risk management. The findings are in line with those of (Brian 2010) in their study, How to assess the credit risk management in the financial institution argue that there were factors hindered effectiveness of credit risk management in the micro finance institution.

However lack of conducive environment is one factors that affects the effectiveness of credit risk management in the microfinance institution, most of the respondents 68.75% do not agree that working environment of Mbinga Community Bank. these findings correspond to those of (Assenga 2008) who argues that some micro finance bank in Tanzania have poor environment for staff to work due to many micro finance institutions are profit oriented, so that shareholders are there for profit which is produced by organisation.

However lack of organisation to pay employee monetary incentive (wages and salaries) is another factor affecting credit risk management, from Table 4.10 of the research data shows that 62.5% of respondents agree that incentives for employee is not enough for the day to day expenses, the findings from the research data are in line with those by (Briet 2001) who found that in order for organisation to succeed in credit risk management it should motivate employees through wages and other incentive in order to increase efficiency, and this is the goal for institution. Also Briet (2001) adds that credit officer have a big impact on MFIs success by creating and safeguarding the quality of loan portfolio in the organisation.

Despite Mbinga Community Bank having employees who work in the organisation still there is challenge of working experience as 43.75% of employees respondent have less than three working experience. Probably this affects effectiveness of credit risk management. The finding are in line with (Luasha 2009) in a study assessing the factors that impede repayment of micro finance loans it revealed that experience on

credit risk is the one factor that MFI that outreach and overall efficiency, and if not it can contort the social purpose of the micro finance institution.

5.2.3 Impact of internal control on credit risk management.

The findings reveal that 75% of the respondents agree that there is inadequate internal control in the organisation. And remaining of the respondent agree that there were internal control in Mbinga Community Bank. The aim of internal control is to achieve accountability in financial matters, In the research data it show that there was no accountability for internal audit to cover the recording of transactions, establishing responsibilities for maintaining financial records including those for assets.

In order to get proper Internal control the staff should follow the policies and procedures established and maintained by management to assist in achieving its objective of ensuring, as far as practical, the orderly and efficient conduct of the entity's business. The responsibility for ensuring adequate internal control is part of management's overall responsibility for the ongoing activities of the entity. The findings correspond with those by (Holtmann 2001) and (Pascal 2010) who argues that some micro finance institution have some challenges facing in the internal control which are follows;

- Few numbers of employees.

Especially in an audit section the MFIs recruited some employees in other sections during the period of the study the researcher, however the audit section was not considered and thus its performance was below by 100% that means it did not fulfil the purpose.

- The internal auditor should observe on regular basis review and evaluate internal control relating to credit risk and adherence to financial regulations.
- Ensure that control documentation for credit process is updated to reflect changes.
- Lack of credit risk knowledge

This is one of the factors affecting credit risk management, credit officer collection that failure to observe credit policy and procedure.

CHAPTER SIX

SUMMARY CONCLUSION AND RECOMMENDATION

6.1 Introduction

This chapter gives the summary of conclusion and recommendation from the previous chapter and when there is a need to conduct further research on the performance of credit risk management in the micro finance institution.

6.2 Summary

The general objective of this study was to assess the performance of credit risk management in the micro finance institution, specifically at Mbinga Community Bank. The study was guided by three specific objectives namely; to identify and examine policies and procedures involved in the credit risk management, to assess the factors that hinder the effectiveness of credit risk management in microfinance institution, and to assess the impact of internal control on credit risk management in the micro finance institution.

The key findings of this study revealed the following:

Despite Mbinga Community Bank having credit policy and procedure but still there was the challenge for adherence to credit policy and procedure in the organisation. One of the challenges was lack of training to staff within the organisation.

With respect to the extent to factors that affect the effectiveness of credit risk management in micro finance institution, their some constrains facing Mbinga Community Bank that was lack of conducive environment, lack of incentives to employees like wages and salaries, and lack of employee experience especially on credit risk management.

The last objective was the impact of internal control in the credit risk management in the micro finance institution. The findings indicate that, despite the fact that there was internal control in the organisation still there was the challenge faced it. One

among the problems was shortage of staff within audit department. Also staff worked more than actual time (over worked).

6.3 Conclusion

From the analysis, interpretation, presentation and summary of the findings as shown in chapter four and five, respectively, the study has drawn the following conclusions. The credit risk management on performance is still low as it is affecting the profitability status of the organisation. It is also concluded that the credit policies are not fully implemented in MCB on top of failing to train the employees on credit terms and controls in place. It can be concluded that although there is a positive relationship, there are other factors affecting the loan performance levels of the organisation. These may include; poor working environment, low motivation levels and low wages, lack of experience from the employee.

6.4 Recommendations.

Based on the finding above on the credit risk management, the researcher should be able to give recommendations from the findings and previous topic especially chapter four. The researcher can come with a suggestion which is better for fulfillment of the report. However most of recommendations from the researcher rest into following areas.

- Management should be able to review our policy and procedure at least after every two years on the credit risks in order to reduce risk in the organisation.
- The organization should review the credit controls in place to make sure that they are effective in increasing loan performance; hence they should try to reduce the level of credit risk.
- It is better for the institution to focus on recruitment of internal auditors (shortage of workers in this department) in order to meet with the satisfaction.
- The institution should work more in creating training and awareness to enhance common understanding across the institution about the issue of credit risk management.

- The institution also is expected to pay particular attention into promoting working environment to retain staff in the organization.
- The institutions should work more on reviewing circular of wages and other allowances for employees in the organisation.

6.5 Area for further research.

Before suggesting the potential additional research in credit risk management, it is obvious that banks face problem of limited experience for their employees on CRM, procedures, lack of employee training and challenging of natural environment. The limited time and scope prevent this thesis from considering credit risk management from more advanced quantitative point of view with a lot of financial complex formulas, credit modules and metrics. Future research should really take this into consideration.

- Credit policy and loan portfolio performance in the microfinance institution.
- Factors that hinder effectiveness on credit risk management and.
- Impact of customer services on customer retention on micro finance institution

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APPENDICES

APPENDIX I

Questionnaire for employee

Dear respondent

I am a student of Mzumbe University carrying out a research aiming at determining the effect of credit management on the loan performance of Micro finance institution. I kindly request you to spare some hours of your time and respond to the questions below either by ticking or filling where applicable. The purpose of these is for a requirement of the award Master degree of accounting and finance Mzumbe University; your answers will be treated with utmost confidentiality.

Thank you for your cooperation

PERSONAL BACKGROUND

1 sex: male ☐ female ☐

2. Age: <25 ☐ 25-35, ☐ 36 and above ☐

3. Educational status in grade degree diploma corticated ordinary level

Certificate

Diploma

Degree

Above degree

4. Marital status

Married ☐ Divorced ☐

Unmarried ☐ windowed ☐

5. The level of position in the organization

Supervisor

PART II SUBJECT MATTER

Kindly answer the few questions below which indeed are designed to give you an opportunity to participate in this initiative for which all of us deserve to be part of.

Questionnaire for credit Officers at Mbinga Community Bank

Kindly answer the few questions below which indeed are designed to give you an opportunity to participate in this initiative for which all of us deserve to be part of.

1. Do you understand by the term credit risk management?

A: If YES How?

.....
.....

B: If No, Why?.....

2. Do you know any policies that guide credit risk management?

A. If YES, mention them

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

B. If NO,

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

3. Are you aware of any procedures involved in credit risk management?

A. If YES, mention

them.....
.....
.....

B. If, NO,

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

4. Do you think the procedures involved in credit risk management have been effective?

A. If YES,

how?.....
.....
.....

B. If NO, why?

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

5. Are you aware of the challenges involved in implementing the credit risk management?

A. If Yes, mention

them.....
.....
.....

6. Are your clients aware of credit risk management?

A. If YES, how do they get the information?

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

B. If NO,

7. Do you have any control mechanisms regarding the implementation of credit risk management?

If YES, mention them

.....
.....

B. If NO Why?

.....

8. Are there any challenges involved in controlling the implementation credit risk management?

A. If YES, mention them

.....

.....

.....

B. If NO,

Why?.....

.....

C.

9. Is Mbinga community bank having a smooth control mechanism?

A. If YES, mention them

.....

.....

.....

B.If NO, Why?.....

10. What is your recommendation about the current mechanism concerning the implementation of credit risk management?

.....

.....

.....

THANK YOU FOR YOUR COOPERATION

APPENDIX II

Interview guide for key informants (purposely sampled)

1. When mbinga Community bank as the institution start work?
2. How you organize the clients
3. How do you control loan repayment?
4. How do you control default?
5. Credit service is a traditional and key service in every bank. What is the credit services that your bank is offering?
6. At this Head office, what kind of credit services that the customers have access to?
7. In your opinion, what types of risks exist in those services?

THANK YOU FOR THE COOPERATION

THE END