CREDIT RISK MANAGEMENT IN DEVELOPMENT FINANCE INSTITUTIONS: A case study of small enterprises development corporation (2009-2012)

BY

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DECLARATION

I, Jimmy Dzinavatonga, do hereby declare that this dissertation is the result of my own investigation and research, except to the extent indicated in the Acknowledgement, References and by comments included in the body of the report and that it has not been submitted in part or in full for any other degree to any other university

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DEDICATION

This dissertation is dedicated to my late mother, Liliosa Zvirimuyhu for her unwavering belief in academic achievement and for failing to live to witness my academic achievements.

May her soul rest in eternal peace.
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ABSTRACT

The study sought to explore credit risk management system peculiar to Development Finance Institutions in Zimbabwe using a case study of Small Enterprises Development Corporation covering the period 2009 to 2012. The study was guided by the following objectives; to establish the sources of default on loans advanced; ascertain the challenges inherent in SEDCO’s credit risk management system and ascertain the adequacy of SEDCO’s credit risk management system. The research was conducted using both quantitative and qualitative approaches with survey and case study as the research designs. Data was collected using questionnaires and interview guides as well as review of available documents and records targeting SEDCO management and employees, loan beneficiaries and senior loans officers from local banks. Data was analysed using descriptive statistics and narrations. The research reviewed that the loan default rate was generally growing with cost of borrowing, politically motivated lending, fraudulent activities and lending without sufficient financial and economic analysis as the main attributing factors. Inability to recruit and retain experienced and skilled employees, inappropriate and inadequate training modules, lending without sufficient past credit history of the borrower emerged as the main Credit risk management challenges. The research also found that the current credit risk management system was adequate and appropriate for the lending activities of the organisation but was lacking on implementation or operationalization. The study recommends that project monitoring has to be intensified, the organisation to immediately use Financial Clearing Bureau for credit referencing, both formal and informal training in credit risk management related courses be pursued, micro lending scheme be temporarily folded up.
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LIST OF ACRONYMS

BOD: Board of Directors

CRB: Credit Reference Bureau

DFIs: Development Finance Institutions

FCB: Financial Clearing Bureau

LIBOR: London Inter-Bank Offered Rate

MIS: Management Information System

MSMECD: Ministry of Small, Medium Enterprises and Cooperatives Development

SADC DFIRC: Southern African Development Community Development Finance Resource Centre

SEDCO: Small Enterprises Development Corporation

SMMEs: Small, Micro and Medium Enterprises
DEFINITION OF TERMS

**Development finance institution** is a financial institution (usually bank) established by single or states to provide finance for the specific needs, at the same time to accelerate economic development, achieve long term economic growth and other government targets by building markets and improving system.

**Southern African Development Community Development Finance Resource Centre** refers to a not for profit organisation, subsidiary institution of SADC established in July 2003 to serve as a sub-region center of excellence to strengthen the SADC DFIs network and to enhance their capacity to deliver on their mandates towards the achievement of economic growth, employment generation and poverty alleviation.

**Financial Clearing Bureau** is an official conduit for the banking and financial sector that provides credit protection needs through its national data bank of clients with civil judgments, on back list and on enquiry.
CHAPTER ONE
INTRODUCTION

1.0 INTRODUCTION
This research sought to investigate the credit risk management challenges faced by development finance institutions in Zimbabwe with specific reference to Small Enterprises Development Corporation (SEDCO). It will look into the background to the study, statement of the problem, justification to the study, objectives and research questions, significance of the study, delimitation of the study, limitations and a chapter summary.

1.1 BACKGROUND TO THE STUDY
SEDCO is a parastatal that came into existence in 1983. It derives its mandate from the SEDCO ACT, Chapter 24:12 of 2001. It falls under development finance institutions character and its parent ministry is the Ministry of Small to Medium Enterprises and Cooperatives Development (MSMECD). It was established to serve Small, Micro and Medium Enterprises (SMMEs) with financial support and general business development services as this segment was facing challenges from traditional banks whenever they approached them to access loans. Over the years, the corporation has been relying on its revolving fund for on-lending to SMMEs but the multiple currency system introduced in 2009 has seen its funds dwindling, hence its inability to meaningfully support the SMMEs sector.

The Corporation has not been spared from high default rate and non-performing loans like any other financial institutions operating in Zimbabwe. Many companies and SMMEs are reported to
be defaulting on loan repayments; recently Gulliver and Valley Technologies had their assets sold through public auction as they failed to service the loans they were advanced by ZB and Afrasia Kingdom Bank respectively (Newsday, 7 May 2013).

The Financial Gazette (3 June 2013) reported that SEDCO had lost over US$1,8 million in its microfinance unit, which had 2000 accounts. The organisation extended about US$2 million in 2012 to SMEs and less than 10% had been recovered. The organisation is said to have recovered only 1.8% of the funding extended to SMEs out of an estimated US$3.5 million loan book. This financial turmoil was blamed on alleged corporate governance rot, fraud, mismanagement and break down in credit risk management system. The Head of SEDCO admitted fraudulent activities to have happened at some of their branches (Ibid).

The Financial Gazette (18 July 2013) also confirmed that SEDCO’s liquidity challenges mainly stemmed from its inability to follow up on overdue loans and some top level management changes were claimed to have been effected to strengthen systems within the organisation.

The Sunday Mail (13-20 October 2013) acknowledged that SEDCO had received US$3.7 million from the Treasury since 2009, with US$200 000 having been received only in 2012. It was also reported that the corporation had been struggling to recover the little it has been disbursing to SMEs and has engaged the services of Darwin Properties to auction properties pledged as collateral security by defaulting SMEs. This was done as a solution to arrest the growing default rate.
The Corporation attributed the failure by Treasury to avail funds for on-lending as the source of its liquidity and viability challenges. It is said to be heavily under-capitalised with a capital of US$4million compared to a capital requirement of US$25million. However, most of its challenges are said to be a result of high default rate with some loans advanced in 2009 still to be recovered (The Sunday Mail, 4-10 August 2013).

On a national level, the level of non-performing loans has been growing from 0.3% in March 2009 to 13.8% in March 2013 against the internationally recommended of 5.8% (Herald, 18 October 2013). This has been attributed to inside lending among directors, inadequate due diligence on loan application, moral hazard, information asymmetry, high interest on short loans and multiple borrowing. Also cited are poor project productivity and profitability, poor project monitoring by banks, violation of prudential guidelines, diversification and misuse of borrowed funds (Ibid).

In Africa, most of the bad debts within financial institutions are said to be attributed to moral hazards, adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending at high interest rates to borrowers in the most risky segments of the credit market while borrowers tend to divert funds to risky investments once they are granted the loans (Brownbridge, 1998).

Palubinskas and Stough (1999) note that the failure of a bank is mainly a result of mismanagement because of bad lending decisions made with respect to wrong appraisal of credit status, or the repayment of non-performing credits and excessive focus on giving loans to certain
customers. Sound credit risk management system aimed at reducing unacceptable or unsustainable loss and lessen uncertainty is very important for the performance of any financial institution (Walraven, 1993). It is thus the essence of this study to assess the credit risk management within financial institutions with particular reference to SEDCO and proffer recommendations to contain broad credit risks.

1.2 STATEMENT OF THE PROBLEM

Loans form a significant part of the asset base of financial institutions. Non-payment of loans impacts negatively on the sustainability and viability of the financial services sector through loss in revenue interest and principal repayments). Development Finance Institutions have already lost substantial amounts of revenue due to loan default and non-performing loans. However, if the credit risk management system within DFIs is not continuously checked, losses may further increase. As a result of the on-going loan default, SMEs demands for business loans may not be fulfilled. The quantum of revenue lost due to loan default as well as the causes of loan default, challenges and adequacy of credit risk management system have not been established as of yet in the Zimbabwean DFIs.

1.3 RESEARCH OBJECTIVES

The main objective of this research is to investigate the credit risk challenges being faced by SEDCO. The specific objectives of the study are:

- To ascertain the level of loan default within SEDCO since 2009.
- To establish sources of default on loans advanced by SEDCO.
- To identify the challenges inherent in SEDCO’s credit risk management system.
• To ascertain the adequacy of SEDCO’s credit risk management system

1.4 RESEARCH QUESTIONS
The study intends to answer the following research questions:
• What is the current level of loan default within SEDCO?
• What are the sources of default for SEDCO loans?
• What are the challenges inherent in SEDCO’s credit risk management system?
• How adequate is SEDCO’s credit risk management system?

1.5 SIGNIFICANCE OF THE STUDY
The findings from this study will be of great value to management at development finance institutions, policy makers represented by central government and the economy at large as described below:

1.5.1 SEDCO MANAGEMENT
The research findings and recommendations of the research are going to be used in influencing policy formulation within the organisation given the confidence associated with academia. This is likely to result in policy shift or managerial approach in as far as credit risk management is concerned.

1.5.2 POLICY MAKERS/MSMECD
The empirical evidence from this study will form at least the baseline under which issues of policy formulation at organisational level will be made. Issues arising from the study will serve in the drafting of organisational policies related to credit risk.
1.5.3 EMPLOYEES

They stand to get insight into the factors that is affecting the organisation’s performance and what really is expected of them to get the organisation perform beyond set targets.

1.5.4 SMALL, MIRCO AND MEDIUM ENTREPRISES

Once findings and recommendations of this research are taken on board, they form part of the need analysis of the customers. Hence, by adopting the recommendations SMMEs are likely to get a packaged service which is driven by their needs and wants. More SMMEs stand to benefit from the organisation’s credit facilities once the organisation manages to keep credit risk under control.

1.6 DELIMITATIONS

The study will focus on the case study of SEDCO; one of Zimbabwe’s largest and oldest development financial institution. This is based on the fact that the organisation has been operating long enough and was formed specifically to serve the SMMEs sector and that alone provides the kind of academic insight the study seeks to achieve. Also, the organisation lends to major sectors of the economy; manufacturing/-value addition, retail, agro-based, cross border trading, services and the informal sector. The organisation has a nation-wide network of 6 branches that cover all the 10 provinces of the country. That will enable broad country inference of the issues under study. The research covered areas of credit risk management within Development Financial Institutions. No attempt will be made to cover areas concerning issues of the economic environment except those that concern the administration of the loan processes.
1.7 JUSIFICATION OF THE STUDY

Lack of access to finance or capital is one of the factors that inhibit SME development in developing countries like Zimbabwe. If adequately funded, SME can immensely contribute to economic growth of a country through employment creation and output as the Asian Tigers. Against this background, this study seeks to identify and analyse factors that are causing depletion in loanable fund (SEDCO revolving fund) and provide recommendations on how they can effectively manage the fund so that it grows and fresh advances can be made. Once strategies are put in place to minimise default, SEDCO is likely to become self-sufficient and frees the central government funds to be directed to other crucial programmes. This will enable continuous access of funding by as many SMMEs who would need it for working, capital expenditure and other purposes. In essence, once SEDCO become financially independent and sound, deserving SMMEs are going to be adequately financed and contribute to national output of the country.

Most studies were mainly concentrating on evaluation of credit risk management within financial institutions in developed and some developing countries (Tracey and Carey, 1998; Tetteh, 2012; Tabakis and Vinci, 2002; Brownbridge, 1998). This study is going to fill that gap and contribute to the existing board of knowledge in finance through looking at credit risk management challenges peculiar to DFIs. More so, the study is undertaken as a mandatory aspect to fulfil the requirements of the Masters in Business leadership degree which the researcher intends to acquire.
1.8 RESEARCH LIMITATIONS

The researcher’s ability to collect information was limited by the Official Secrecy Act which prohibited organizational members from disclosing information about internal affairs of the organization. In this regard, the researcher requested for permission to use the organisation as a case study through the office of the General Manager.

This research is limited to SEDCO Credit Risk Management System and therefore the findings, analyses and recommendations do not represent the entire players within the DFIs sector. The extension of the analysis to other DFIs may offer different results. Cross border research may also bring out different outcomes and regulatory policies. Generalisation is thus, only to other cases that represent similar theoretical conditions.

1.9 ORGANIZATION OF THE STUDY

The study is in five chapters. This current chapter discussed the background, statement of the problem, objectives, research questions, limitations, delimitations, justification and significance of the study. Chapter two undertakes a review of literature on credit risk management policies, procedures and the credit process with a focus on the credit risk management system of SEDCO. Chapter three deliberated on the methodology used for the study. Chapter four presents and discusses the empirical results of the study. In chapter five, the summary, conclusions, recommendations of the study and future areas of research are provided.

1.10 CHAPTER SUMMARY

The author has given a background to the study thus, giving some brief information about the organization under study. The chapter also covered statement of the research problem, justification of the study, objectives of the study, research questions, and delimitations of the study, research limitations, and chapter summary. The following chapter is going to focus on
related literature pertaining to credit risk management.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION
The previous chapter provided the outline of the background of the study, statement of the problem, research objectives, research questions, significance of the study, delimitation, justification of the study and research methodology.

This chapter focuses on reviewing both the theoretical and empirical literature on credit risk management. It analyses concepts, principles and fundamentals of credit risk management at the same time establishing their relevance in the context of development financial institutions in Zimbabwe. The chapter also identifies gaps in previous studies on credit risk management which the study intends to fill. All the above would not be adequate without a review of the practices, principles and processes of risk management within development finance institutions as it relates to sound credit risk management.

2.1 OVERVIEW OF CREDIT RISK MANAGEMENT

Quite a number of authorities have written on this subject, Conford (2000) defined credit risk as the possibility that the actual return on an investment or loan extended will deviate from that which was originally expected.

Walraven (1993), reinforced by considering it to arise whenever promised cash flows on a primary securities held by the financial institution fails to repay the loan. Coyle (2000) concurred with Conford (2000) and defined it as losses from the refusal or inability of credit customers to pay what is owed in full and on time. Adding on, Bluhm et al (2002) described it as the risk of loss faced by an investor whenever a borrower does not make payment as promised. From the above definitions, it appears both authors share the same meaning of credit risk. Credit risk can then be defined as the chance that a debtor may not be able to pay interest or repay the principal
loan advanced according to the terms specified in the credit or loan agreement. It can also be referred to as default risk, performance risk or counterparty risk.

Credit risk management is defined as identification, measurement, monitoring and control of risk arising from the possibility of default in loan repayments (Early, 1996; Coyle, 2000). Lindergren (1987) went a step further and identified key principles in credit risk management as establishment of a clear structure, allocation of responsibility and accountability, identification of processes to be prioritized and disciplined, clear communicated responsibilities and assignment of accountability.

According to the Demirguc-Khunt and Huzinga (1999), the overwhelming concern on bank credit risk management is two-fold. First, the Newtonian reaction against bank losses is a realization that after the losses have occurred that the losses are unbearable. Secondly, recent developments in the field of financing commercial paper, securitization, and other non-bank competition have pushed banks to find viable loan borrowers. This has seen large and stable companies shifting to open market sources of finance like bond market. The organization and management of the lending function should be done in a highly professional manner and pro-actively manner so that the credit risks can be minimized. Banks can maximize on increasingly sophisticated risk management techniques and practices (Gill, 1989).

Mabvure et al (2012) indicate that in the recent years, the recognition of a need for changes in the way financial institutions execute their credit risk management functions began with a number of spectacular well publicized bank failures. Examples are Renaissance Merchant Bank, Interfin Bank Limited, Genesis Investment Bank and Royal Bank Zimbabwe Limited which
were placed under curatorship between 2011 and 2012. Much of the problems according to them, were attributed to chronic liquidity challenges, persistent losses, corporate governance deficiencies and weak internal controls, high level of non-performing insider and related exposures.

Greuning and Bratanovic (2003) pointed out that risk that is inherent in banking should be recognised, monitored and controlled. Hence there is need to put in place a risk management policy to serve as a beacon to both management and other members of staff when implementing risk management techniques.

The issues pertaining to credit risk management brought by above authors adequately provide the realistic situation to Zimbabwean organizations relating to credit risk management as this area is applicable to most economies regardless of their level of economic development.

2.2 ORIGINATION OF BORROWER AND CREDITOR RELATIONSHIP

There are many different individuals; businesses and parties that make the financial system functional, among them are creditors and debtors and their relationship will be based on debt (Allen et al, 1997). The lender extends a loan or line of credit for a certain amount and a borrower agrees to repay those funds according to terms outlined in a contract (Ibid). A creditor is one who extends or lends money to an individual, business organisation or government while a debtor is the one doing the borrowing. The relationship between a debtor and creditor can be positive if everyone follows the terms that were agreed upon at the onset of the contract, but it does not take too much for sentiment to turn negative if one party fails to hold up the bargain. A retailer and supplier may represent a debtor and a creditor
relationship (Santomero, 1988).

In the financial world, a debtor and creditor relationship may exist, where bonds are issued by corporations, governments and municipalities (Saunders and Anthony, 1997). Issues are considered debtors and investors who buy the bonds which are debt instruments are considered the creditors. It is the responsibility of the debtor to repay a creditor according to terms that include duration of repayment, an interest rate tied to the credit worthiness of the debtor and the principal amount of the loan. In this scenario, the relationship between a debtor and creditor is one that is senior to a debtor’s relationship with equity holders (Ibid). For example, if an issuer becomes insolvent and files for bankruptcy protection, a bondholder is a creditor that holds seniority for repayment over stockholders.

2.3 WHAT IS CREDIT?

Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest (www.Investopedia.com/terms/c/credit.asp accessed on 7/12/13 at 10:15AM). The Eastern Caribbean Central Bank (2009) offered a similar definition of credit as the provision of funds on agreed terms and conditions to a borrower, who is obliged to repay the amount borrowed together with interest thereon. The website www.glossary.econguru.com/economic accessed on 7/12/13 concurred with the above definition and defined credit as the promise of future payment in exchange for money, goods, services or anything else of value. Credit can take the form of car loans, mortgages, credit cards, corporate bonds, commercial paper to government securities to name a few.

Sullivan et al (2003) further reinforced the definition by defining it as the trust which allows one
party (lender) to provide resources to another party where that second party does not reimburse the first party immediately (thereby generating a debt) but instead arranges either to repay or return those resources (or other materials of equal value) at a late date. Sullivan went a step further and clarifies that resources so provided could be financial (granting a loan) or they may consist of goods or services (consumer credit). By and large, credit takes any form of deferred payment where a creditor or lender extends it to a debtor or a borrower.

Ingham (2004) simplified the definition to privilege of using someone else’s money to purchase an item or service now and then pay for it later. Credit does not necessarily require money as it can also be applied in barter economies, based on the direct exchange of goods and services (Ingham, 2004). It appears from the above definitions that credit is usually advanced to individuals, organisations that promise to repay at a future date as defined and agreed in the loan agreements.

2.4 WHY CREDIT?

There are many and diverse reasons as to why individuals, SMEs and organisations require external financing and credit. The first reason could be borrowers do not have sufficient financial resources to make a purchase. It also helps borrowers to afford an expensive purchase for instance to acquire a business or equipment. Potential borrowers may not have the amount of money to make the purchase but a credit can allow such a purchase to be made. Since payments are staggered, this makes credit affordable as this enable the borrower to pay off the loan gradually. The credit also allows one to get the funding he needs without necessarily waiting for
him to build substantial savings afford starting a business or expanding the business.

The reason for a credit can be explained under short term, medium term and long term loans. In Zimbabwe most loans falls under the short term loans and as such they are explored further.

2.5 FORMS OF CREDIT

2.5.0 SHORT TERM LOANS

This is a form of financing where the financial obligations must be fulfilled within one year or two years (www.investopedia.com/terms/c/credit.asp accessed on 6/12/13). Are loans that must be repaid within a year or less at a determined interest rate (Heffernan, 1996). The facility is not revolving by character as it has a fixed repayment period. This facility is most suited to potential debtors facing liquidity problems or who want to finance working capital requirements of the business for example purchasing of stock or paying of creditors, rent, wages, electricity and raw materials. There are five main types of short term debt financing options:

2.5.1 OVERDRAFT

This involves a company or individual drawing or transmitting cash from its account beyond their available balance with their banker (www.investopedia.com/terms/c/credit.asp accessed on 6/12/13). The facility is revolving by character as it does not have a fixed repayment period and the amount of credit will depend on the overdraft limit negotiated with the bank. It has the advantage in that the company does not have to ensure that sufficient cash is always available for operating activities like stock turnover or payment to creditors in the short term.
2.5.2 LETTER OF CREDIT

This is a letter from a bank, guaranteeing a buyer’s payment to a seller, that a seller will receive the amount within the credit period (Herring and Santomero, 1991). The main advantage with this facility is that it enables the buyer to negotiate better credit terms with suppliers for example extended or longer credit period.

2.5.3 TRADE CREDIT

Trade credit is finance obtained from suppliers of goods and services over a period between delivery of goods (or provision of a service) and the subsequent settlement of the account by the recipient (Pike and Neale, 2006). The main advantage of this form of credit is that it allows the company to enjoy the goods or benefit from the service provided without having to pay upfront. It carries with it both hidden and overt costs for instance excessive delay in settling invoices can undermine the stability of the business as existing suppliers may be unwilling to extend more credit until existing accounts are settled or they may start to assign lower priority to future orders placed by the business and may raise prices in the future or they may simply not supply at all (Ibid). Above all, once a firm acquires a reputation as a bad payer among the business community, its relationships with other suppliers may be soured. This facility is mainly applicable in the goods market.

2.5.4 TERM LOANS

According to Pike and Neale (2006), these are loans made by a bank for specific period or term, usually longer than a year. Term loans can be arranged at variable or fixed rates of interest, although the interest cost is usually higher with fixed rates of interest and an arrangement fee is usually charged. For variable rate loans, the rate set may be two to five percentage points above the bank’s base rate, depending on the credit rating of the client and the quality of the assets offered as security (Ibid). The
salary based loans has gained current within the Zimbabwean financial sector were loans are secured by one’s monthly salary.

2.5.5 MONEY MARKET INSTRUMENTS: BILL FINANCE

Bills represent a commitment to pay out a specific sum of money after a specified period of time. They are traded on the money market, which is seized with providing funds repayable over periods of less than a year. The major players in the money market being commercial banks lend to each other usually overnight to cover temporary cash shortages, at the London Inter-Bank Offered Rate (LIBOR) and to discount houses (Pike and Neale, 2006). Discount houses primarily deal with short term bills issued by the government (Treasury Bills), local governments and companies. They borrow on competitive interest rate and use the proceeds to purchase bills which they may hold to maturity or sell at a profit in the money market. A business can use two main types of bill to raise finance:

2.5.5.1 BILLS OF EXCHANGE

Bill of exchange is a document that binds one party to pay a fixed sum of money to another party at a specified future date (Heffernan, 1996). According to Pike and Neale (2006), the trader purchasing goods draws up a bill stating a promise to repay at some future date and then conveys the bill to the supplier of the goods. The suppler may then hold until maturity or sell it in the market to a discount house, if cash is required earlier. The terms of the bill usually include an implicit interest charge although no interest is paid. This instrument is usually used in international trade wherein an exporter can grant credit to an importer for goods shipped by drawing a bill of exchange to the same amount and credit period.
2.5.5.2 ACCEPTANCE CREDITS

They are often called bank bills and are drawn by a company on a bank (Heffernan, 1996). The bank grants a credit facility whereby a client company can draw bills (up to an agreed limit) that the bank will accept, that is, agree to honour, when presented for payment at a future specified date (Pike and Neale, 2006). The client company may not use the facility immediately, but may treat it as a standby to be used when required. Accepted bills are sold on the discount market by the bank on behalf of the client company at a relatively low discount (Ibid). The company thus effectively obtains finance from the purchaser of the discounted bills, using the name and reputation of the accepting bank as security. This can be viewed as a way by which one company lends to another, through intermediary services of the bank.

Bank bills have a period to maturity of 30, 60, 90 or 180 days (Ibid). At maturity date, the bank can either accept a new bill, that is effectively roll over the old one or receive the full value of the bill from the client’s account, using the funds to pay the bearer of the bill. The cost to the client is usually the amount of discount on the bill plus a fee payable to the bank. Their advantage is that they can be negotiated for longer periods than overdrafts, thus offering more security to the borrower. However, they are only available to large companies with sound credit ratings and they lack the flexibility of overdrafts, which a firm can reduce if it wishes to lower interest costs.

2.6 MEDIUM TERM FINANCE

These are advances extended with a repayment period in the range of five to ten years.
2.6.1 HIRE PURCHASE

It is also known as Asset Purchase, where the user of the asset will eventually own it. This form of financing is readily available as the loan is secured by the asset acquired. The hirer makes a down payment and then signs a commitment to a series of monthly instalments over a specified period, at the end of which the legal title to the article passes to the user (Pike and Neale, 2006). The hire charge contains two elements that is, interest charge to reflect the borrowing of the capital involved and a capital repayment element. This form of financing is advantageous in that it allows immediate availability of the asset for use without necessarily having to pump out more cash at the outset of the project. Its main disadvantage is that in the event of the hirer failing to fulfil the payment schedule, the owner can repossess the asset. The hirer will loses all title to the asset and obtains no credit for payments already made (Ibid). However, this form of financing have remained relevant within the consumer markets especially the market for furniture and other consumer durables.

2.6.2 LEASING

Pike and Neale (2006) defined leasing as a way by which companies obtain the use of equipment when, for varying reasons, they may wish to avoid acquiring it outright using other financing methods. Leasing involves important interactions between the investment and financing decisions. The lessee, a company wishing to obtain the use of an asset will approach the lessor (the firm offering equipment or other assets) with its requirements and the latter provide for such requirements for a specified series of rental payments over an agreed time period (Ibid). This facility is no longer visible within the Zimbabwean economy serve mainly to banks for their Information Technology needs.
2.6.3 FORFAITING

This is a form of medium term export financing that involves the purchase by a bank (the forfeiter) of a series of promissory notes, usually due at six month intervals over perhaps three to five years, signed by an importer in favour of an exporter (Heffernan, 1996). The notes are usually guaranteed by the importer’s bank and then sold by the exporter to the forfaiting bank at a discount. The bank pays the exporter allowing it to finance the production of the goods destined for export and enabling the importer to settle later. The promissory notes are held by the forfeiter for collection as they mature, on a without recourse basis, thus the exporter is not liable in case of default by the importer (Pike and Neale, 2006).

The rate of discount applied in forfaiting depends on the terms of the notes, the currencies of denomination, and the credit ratings of the importer and of the bank that guarantees the notes as well as the country risk of the importer’s base (ibid).

2.7 LONG TERM FINANCE

Long term loans are usually advanced to corporate entities that have a repayment period of more than ten years (Tetteh, 2012). The business can raise long term funds internally from the business’ cash flow or externally through the capital market. The capital market channel finance from persons and organisations with temporary cash surpluses to those with, or expecting to have, cash deficits. Major players within this market includes major institutions like pension funds, insurance companies and banks who collect relatively small savings and channel them to companies and other organisations seeking capital. The following are the main forms of raising long term finance:
2.7.1 SHAREHOLDERS’ FUNDS

- **Ordinary Shares**

Investors buy a portion or share of the ownership of the firm and become the shareholder with some degree of control over the company. They exchange their funds in return for shares. Issued capital forms the backbone of the company’s capital structure with ordinary shareholders carrying full rights to participate in the business through voting in general meetings (Pike and Neale, 2006). They are entitled to payment of a dividend out of profits and ultimately, repayment of capital in the event of liquidation, but only after all other claims have been met.

- **Preference shares**

They constitute part of shareholders’ funds, but holders receive an annual dividend, usually a fixed percentage of the par value (Pike and Neale, 2006). Holders also have preferential rights over ordinary shareholders. Preferred dividends are paid before ordinary share dividends and preference capital precedes ordinary share capital when assets are sold in liquidation and the sale proceeds are distributed.

- **Reserves**

They are also part of shareholders’ funds and are profits retained from the recently ended or preceding years. Internal finance, including retained profits provides the main source of new capital for companies as it is less costly than selling new shares (Pike and Neale, 2006).

2.7.2 DEBT INSTRUMENTS

2.7.2.1 DEBENTURES
Pike and Neale (2006) defined a debenture as a document acknowledging that the firm has borrowed money which is secured on the assets of the company by mortgage deeds. In the event of the issuer going into liquidation or defaults on interest or capital payments the holder can apply for a court ruling to order the sale of either specified assets of any of the firm’s assets. The firm cannot dispose of assets subject to a fixed charge without the permission of the creditors.

With respect to priority for payment, holders of the earlier issued debentures must be paid interest before the later comers and where a firm has issued a series of bonds, a pari passu clause is inserted into the document acknowledging the debt (ibid).

2.7.2.2 ASSET BACKED SECURITIES

These are securities backed by a reliable long term stream of future earnings as opposed to physical assets (Pike and Neale, 2006). Examples of such assets include intellectual property like patents and copyrights. Firms can effectively capitalise their future income into a single lump sum and by selling it on the financial markets to generate immediate cash.

2.7.2.3 CONVERTIBLES

According to Pike and Neale (2006) convertibles begins life as a form of debt, but carries the right at the holder’s option to convert into ordinary shares at some specified date in the future and on specified terms. Issuing of convertibles increase the issuing company’s gearing ratios and may be viewed as being more risky. However, they are particularly suitable for companies facing relatively high business risks but strong potential growth because they offer investors the possibility of participating in future prosperity.
2.8 THE PROS AND CONS OF CREDIT

Credit is an extremely wide-spread and critical part of the economy with most expenditure within an economy being made through credit. Most business capital and consumer car and home purchases could be difficulty to raise or acquire without credit (Sullivan et al, 2003). This is so because of the mismatch between cash inflows and cash outflows (Ingham, 2004). For example the time lapse between paying for inputs and selling output means that businesses need credit to enable them to produce more goods and services.

Despite the advantages of generating huge profits to the lender in the form of interest income and other loan administration fees, it is fraught with equally high risk called credit risk. Basel (1999), posits that exposure to credit risk is the leading source of problems in banks word wide. Management time and expenses are also high when dealing with problem loans. Resolving problem loans takes up more time and effort and can often be expensive as lawyers have to be paid where, for instance, the right to dispose of collateral security has to be exercised.

2.9 RISK MANAGEMENT

According to State Bank of Pakistan (2010), risk management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. Williams et al (1998) assert that risk is a function of circumstances in which more than one outcome is possible. Bank of Tanzania (2010) identified the goal of risk management as that of optimising the risk-reward trade off that can be achieved through putting in place an effective risk management framework which can adequately capture and manage all risks an institution is exposed to. The

2.9.1 RISK IDENTIFICATION

Institution should identify existing risks or risks that may arise from both existing and new business initiatives for them to effectively manage risks (Oldfield and Santomero, 1997). Risk identification should be a continuing process and should occur at both the transaction and portfolio level (Bank of Tanzania, 2010). This should be the first leg of the risk management process and should be thorough and exhaustive as failure to identify the risks faced by the organisation could lead to application of inappropriate risk strategies.

2.9.2 RISK MEASUREMENT

If you can’t measure risk you, can’t manage it (Monetary Authority of Singapore, 2003). It then follows that once risks have been identified, they should be measured to determine their impact on the institution’s profitability and capital (Bank of Malawi, 2007). This can be achieved through utilising various techniques ranging from simple to sophisticated models. According Bank of Tanzania (2010), an institution that does not have a risk measurement system has limited ability to control or monitor risk levels. Accurate and timely measurement of risk is essential to effective risk management systems. Good risk measurement systems should be capable of assessing the risks of both individual transactions and portfolio (Bank of Malawi, 2007).
2.9.3 RISK MONITORING

An effective Management Information System (MIS) has to be put in place to monitor risk levels and facilitate timely review of risk positions and exceptions (Bank of Tanzania, 2010). Monitoring reports should be frequent, timely, accurate and informative and should be distributed to appropriate individuals to ensure action when needed (Bank of Malawi, 2007).

2.9.4 RISK CONTROL

This process entails establishing and communicating risk limits through policies, standards and procedures that define responsibility and authority (Bank of Malawi, 2007). Institutions may also apply various mitigating tools in minimising exposure to various risks. Institutions should have a process to authorise and document exceptions or changes to risk limits when warranted (Bank of Tanzania, 2010).

2.10 CREDIT RISK MANAGEMENT PROCESS AND CYCLES

According to The Bank of Mauritius (2004), the credit risk management process should cover the entire credit cycle starting from the origination of the credit in a financial institution’s books to the point the credit is extinguished from the books. It should provide for sound practices in credit processing, credit approval, credit documentation, credit administration, disbursement, monitoring and control of individual credits, monitoring the overall credit portfolio, credit classification and managing problem credits (Ibid).

2.10.1 CREDIT PROCESSING / APPRAISAL

At this stage all required information on credit is gathered and applications are screened (Eastern
Caribbean Central Bank, 2009). Credit application forms should be adequately detailed to permit gathering of all information needed for credit assessment at the outset (Bank of Mauritius, 2004). A checklist must be in place to ensure that all require information is gathered.

According to Bank of Mauritius (2004), financial institutions should set out pre-qualifications screening criteria, which would act as a guide for their officers to determine the types of credit that are acceptable. For instance, the criteria may include rejecting applications from blacklisted customers. The criteria should help banks to avoid processing and screening applications that would later be rejected.

Bank of Malawi (2007) added that all credits should be for legitimate purposes and adequate processes should be established to ensure that financial institutions are not used for fraudulent activities or activities that are prohibited by law or are of such nature that if permitted would contravene the provisions of law. Bank of Mauritius (2004) concurs and advised banks avoid granting credit to customers of questionable repute so as to minimise reputational risk. After credit screening, banks should then carry out credit appraisal by way of assessing the customer’s ability to repay. Banks should establish well designed credit appraisal criteria to ensure that facilities are granted only to credit worthy customers who can make repayments from reasonably determinable sources of cash flow on a timely basis (Monetary Authority of Singapore, 2003).

Santomero and Babbel (1996) went a step further and identified collateral and guarantees as merely instruments of risk mitigation not substitutes for a customer’s ability to generate
sufficient cash flows to honour his contractual repayment obligations. In that respect, Santomero and Babbel emphasised that collateral and guarantees should not minimise the need for a comprehensive assessment of the customer’s ability to repay nor compensate for scant information from the customer.

The Bank of Mauritius (2004) advised the need for financial institutions must have a policy for valuing collateral which should provide for ensuring acceptability of various forms of collateral, their periodic valuation, process for ensuring their continuing legal enforceability and realization value. Mwisho (2001) posits that value of collateral should be conservatively determined as in the event of credit deterioration, credit enforcement or foreclosure efforts may yield proceeds much less than initially anticipated.

2.10.2 CREDIT APPROVAL / SANCTION

Bank of Mauritius (2004) posited the need for a bank to have in place written guidelines on the credit approval process and the approval authorities of individuals or committees as well as the basis of those decisions. Approval authorities should be sanctioned by the board of directors and should cover new credit approvals, renewals of existing credits and changes in terms and conditions of previously approved credits, particularly credit restructuring, all of which should be fully documented and recorded (State Bank of Pakistan, 2010). Those empowered with the credit approval authority should not also have the customer relationship responsibility and should hold positions and expertise commensurate with such authority (Ibid).
According to the Bank of Mauritius (2004) the approval process should be based on system of checks and balances. Some approval authorities should be reserved for the credit committee in view of the size and complexity of the credit transaction (Mataruke and Jubenkanda, 2005). It comes out clearly from the issues raised above that both approval limits and delegation of authority should be spelt out in writing and be observed every time when advancing credit.

2.10.3 CREDIT DOCUMENTATION

This part of the credit process is very important and is required for each phase of the credit cycle. The format of credit files must be standardised and files neatly maintained with an appropriate system of cross-indexing to facilitate review and follow up (Bank of Mauritius, 2004). Documentation will form the basis for any legal action in the courts and therefore lending institutions must ensure that contractual agreements with their borrowers are continuously reviewed by legal experts (State Bank of Pakistan, 2010). All applications received by the bank should be documented regardless of their approval or rejection (ibid). This stage appears to form the basis of follow ups and recovery efforts from which absents of files are likely to frustrate building up of a quality portfolio.

It is the prerequisite of any bank to establish policies regarding information to be documented at each stage of the credit cycle. The depth and detail of information from a customer will depend on the nature of the facility and his prior performance with the bank (Mataruke and Jubenkanda, 2005). A separate credit file should be maintained for each customer.

Ward (1993) established that lending officers are responsible for the development of appropriate
credit documentation and for subsequent changes in such documentation. Expectations would include:

That if the credit is in the special attention category (for instance because of concern for the customer’s credit worthiness), changes may need to be approved by senior credit officers or the credit committee. Waivers of documentation or other credit agreement requirements require lending officer’s approval plus written concurrence of a senior lending officer and the bank’s loan administration division.

2.10.4 CREDIT ADMINISTRATION

Banks should ensure that loan agreements are duly prepared, signed, renewal notices are sent systematically and credit files are regularly updated (State Bank of Pakistan, 2010). The credit administration function can be allocated to a separate department or to designated individuals in credit operations depending on the size and complexity of its credit portfolio (Mataruke and Jubenkanda, 2005). It should ensure that:

- Credit files are neatly organized, cross-indexed and their removal from the premises is not permitted;
- The borrower is making timely repayments of lease rents in respect of charged leasehold properties;
- Credit facilities are disbursed only after all the contractual terms and conditions have been met and all the required documents have been received;
- Collateral value is regularly monitored;
- The borrower is making timely repayments on interest, principal and any agreed to fees and commissions;
• Information provided to management is both accurate and timely;
• Responsibilities within the financial institution are adequately segregated;
• Funds disbursed under the credit agreement are, in fact, used for the purpose for which they were granted;
• The established policies and procedures as well as relevant laws and regulations are compiled with; and
• Onsite inspection visits of the borrower’s business are regularly conducted and assessments documented (Bank of Mauritius, 2004).

It appears this stage cuts across many credit stages from documentation, disbursement, monitoring to maintenance of credit files, collateral and security documents. It then follows that failure to have a sound credit administration section or function within any lending institution will likely to result in high credit risk or bad loan book.

2.10.5 DISBURSEMENT

Upon approval of the credit, the borrower should be advised of the terms and conditions of the credit by way of offer letter (Bank of Malawi, 2007). The duplicate of the offer letter should be duly signed and returned to the institution by the customer together with the acceptance letter (Bank of Tanzania, 2010). The disbursement process should start upon receipt of these letters and should involve the completion of formalities regarding documentation, registration of security, payments of loan administration fees and the vetting of documents by legal experts (State Bank of Pakistan, 2010). Funds should only be transferred upon fulfilment of the pre-disbursement conditions and approval by the relevant authorities within the bank (Bank of Mauritius, 2004).
2.10.6 MONITORING AND CONTROL OF INDIVIDUAL CREDITS

As a panacea to arrest potential losses, problem clients or facilities should be identified early by putting in place a proper monitoring system. A system that will provide the basis for taking corrective actions when warning signs point to a deterioration in the financial health of the borrower (Mwisho, 2001). Lenders must put in place a system to formally review the status of the credit and the financial health of the borrower at least once a year (Bank of Tanzania, 2010). According to Bank of Mauritius (2004) more frequent reviews of at least after every two months should be carried out for large credits, problem credits or when the borrower is faced with operating challenges. By and large the monitoring activity of any lending institution should ensure that:

- Funds advanced are used only for the purpose stated in the customer’s credit application;
- Financial condition of a borrower is regularly tracked and management advised in a timely fashion;
- Borrowers are complying with contractual covenants;
- Collateral coverage is regularly assessed and related to the borrower’s financial health;
- The institution’s internal risk rating reflect the current condition of the customer;
- Contractual payment delinquencies are identified and emerging problem credits are classified on a timely basis; and
- Problem credits are promptly directed to management for remedial actions.

Borrowers should be probed on causes of any major variances in projections provided in support of his credit application and the actual performance, especially variances in projected cash flows and sales turnover (Bank of Mauritius, 2004). For this process to be effective, the reports
produced should be integrated into the MIS of the organisation so that every level of management can keep track of each and every account.

2.10.7 MONITORING THE OVERALL CREDIT PORTFOLIO / STRESS TESTING

This involves analysing what could potentially go wrong with individual credits and the overall credit portfolio if conditions in which borrowers operate change significantly. The results of the analysis should then be fed into the assessment of the adequacy of provisioning and capital of the bank (Bank of Mauritius, 2004). The analysis can then provide for previously undetected areas of potential credit risk exposure that could arise in times of crisis (State Bank of Pakistan, 2010).

The following scenarios have to be considered when carrying out stress testing:

- Significant economic or industry sector downturns;
- Adverse market-risk events; and
- Unfavourable liquidity conditions.

Banks should have industry profiles in respect of all industries where they have significant exposures and the profiles must be reviewed every year. Each stress test must be followed by a contingency plan as per recommended corrective actions (Bank of Mauritius, 2004). Senior management must regularly review the results of stress tests and contingency plans. The results must serve as an important input into a review of credit risk management framework and setting limits and provisioning levels (Ibid). This process seems to be most suitable for financial institutions in economies faced with relatively stable and predictable economic conditions and whose Information Technology savvy is at an advanced stage.
2.10.8 CLASSIFICATION OF CREDIT

This process involves grading individual credits in terms of the expected degree of recoverability. Banks must put in place, processes and controls to implement the board approved policies which must be in sympathy with the central bank’s guideline on credit classification (Bank of Mauritius, 2004). They should have appropriate criteria for credit provisioning and write off (ibid). Financial institutions must therefore, establish appropriate systems and processes to identify credits with similar characteristics in order to assess the degree of their recoverability on a portfolio basis.

2.10.9 MANAGING PROBLEM CREDITS / RECOVERY

The credit risk policy of any financial institution should clearly set out how problem credits are to be managed. Again like loan administration, the positioning of this responsibility in the credit management of an institution may depend on the size and complexity of credit operations. It may form part of the credit monitoring section of the credit department or located as an independent unit within the department (Bank of Mauritius, 2004). This stage involves rehabilitation of the borrower, restructuring of credit, monitoring the value of pledged collateral security, scrutiny of legal documents and dealing with lending officer until the recovery matters are finalized.

However, it more prudent to segregate the management of problem credits from the area that originated the credit in order to achieve a more detached review of problem credit, including rehabilitation of the borrower, restructuring of credit, monitoring the value of applicable...
collateral, scrutiny of legal documents and dealing with receiver / manager until the recovery matters are finalised \((lbid)\). This process calls for a properly resourced and adequately staffed department as it requires be in touch with the borrower and litigation costs.

Banks should put in place a system that ensures senior management is regularly updated on all developments in the recovery process. All steps and recovery efforts by a bank in pursuing its claims against a delinquent customer, including any legal steps initiated to realise collateral must be documented on the file \((\text{Bank of Mauritius, 2004})\). Where there is a delay in the sequestration of collateral or other credit recovery processes, the rationale should be properly documented and anticipated actions recorded, taking into account any revised plans submitted by the borrower \((lbid)\). The accountability of individuals / committees who sanctioned the credit as well as those who subsequently monitored the credit should be revisited and responsibilities ascribed \((lbid)\). Successful recoveries therefore, depend on the credit documentation and administration, with good credit documentation and administration usually results in successful recoveries as court cases are likely to be won in the presence of overwhelming evidence.

2.11 THEORITICAL LITERATURE

The theory of asymmetric information and discouraged borrower forms part of the theoretical literature for this study and will be discussed.

2.11.1 THEORY OF ASYMMETRIC INFORMATION

Loans make up the bulk of bank’s assets \((\text{Njanike, 2009})\), with interest on loans contributing significantly to interest income of financial intermediaries \((\text{Havrilesky and Boorman, 1994})\).
Despite advancing loans being a lucrative venture, it is fraught with a problem called credit risk (Koch and MacDonald, 2000). With argument thrown by the theory of asymmetric information, it may be difficult to distinguish good borrowers from bad borrowers (Auronen, 2003), which may result in adverse selection and moral hazards. Asymmetric information problem arises when banks or lenders have less accurate information than borrowers regarding potential returns and risks associated with the projects of borrowers. This give rise to adverse selection problem a situation in which in the absence of adequate information about borrowers, lower quality borrowers with a higher credit risk are the ones finally selected for the loans.

On the other side, moral hazards occur after the transaction when one side of the economic activity engages in activities that are undesirable for the other side in terms of their agreement. According to Stiglitz-Weiss (1992), they arise when an individual make less effort to avoid misfortune. Generally, the part that possesses more information on a specific item to be transacted (borrower) is in a position to negotiate optimal terms for the transaction than the other party (lender) (Auronen, 2003). The party that has less information about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Both adverse selection and moral hazards have caused substantial accumulation of non-performing loans in banks (Bester, 1994; Bofondi and Gobbi, 2003). There is need for lenders to monitor and supervise borrowers’ activities so as to minimise adverse selection and moral hazard problem.

2.11.2 THEORY OF DISCOURAGED BORROWERS

Kon and Storey (2003) developed this theory with reference to credit markets. They defined discouraged borrowers as good borrowers who do not apply for a loan to a bank since they feel
that they will be rejected. They hypothesise that the scale of borrower discouragement should depend on three factors: the scale of application costs, the bank’s screening error and the interest rate difference between banks and money lenders. Borrower discouragement should be at minimum when banks have no information about firms and allocate funds by lottery.

Contrarily, borrower discouragement is at maximum when banks have some but not perfect, information about firms. However, when both banks and firms are perfectly informed, there is no borrower discouragement. Hence, Kon and Storey (2003) reason that the level of a firm’s discouragement is affected by the amount of information, application costs and sources of funding and that the number of discouraged borrowers would increase with less information, with higher application costs and with fewer alternative sources of finance. However, Kon and Storey’s definition of discouraged borrowers is difficult to apply to an empirical analysis as good may not be easy to quantify and they did not provide any guidance how to quantify the same. Cavalluzzo et al (2002) defines discouraged borrowers as business owners who avoid applying for credit for fear of being rejected and labels the process as “pre-screening and self-selection issue”.

Unlike Cavalluzzo et al (2002), Diagne (1999) explores in greater detail how and why borrowers may be discouraged. He suggests that a potential borrower will face the maximum credit limit which is determined by events under a lender’s or a borrower’s control or even out of the control of both. The borrower behaviour and her decision to apply for a loan are determined by two factors: her expectation about the likely value of the credit limit and its variability. Discouraged borrowers according to him are borrowers who give up seeking loans because they expect either
high costs for getting loans or they expect to face very low credit limits. Hence, these firms self-select into staying out of the credit markets even though they have a need for bank loans.

Diagne (1999) indicates that these discouraged borrowers may be wrong in their expectations since they may get loans at reasonable costs. There is need for banks and other financial intermediaries to spend their energies in identifying this potential lucrative market and capture it so as to create a good loan portfolio.

2.12 CONTEXTUAL LITERATURE

2.12.1 CREDIT CRITERIA

Banks must have a process to analyse beneficiaries’ ability to service a facility advanced to them. In some instances, stringent policies must be put in place to prevent individuals that involve in fraudulent activities or crimes from accessing a facility. This can be achieved by utilising the factors often referred as 5Cs. They include Character, Capacity, Capital, Condition and Collateral. Banks can make use of reliable source of references, accessing credit bureaus, or becoming familiar with individuals responsible for managing a company and checking their references and financial conditions (Fun Ho and Yusoff, 2009). Banks should desist from advancing credit to reputable borrowers simply because they are known to the institution (Tetteh, 2012).
The factors depicted in figure 2.1 include income, amount of existing personal debt, number of accounts from other sources and credit history. A bank is at liberty to use any credit factor in granting or denying a credit application. Swarens (1990) reinforced this by suggesting that the most pervasive area of risk is on overly aggressive lending practice where loan tenure are extended beyond the useful life of the corresponding collateral. This can also include, extending loans to borrowers who are already overburdened with debt or possess unfavourable credit history as this exposes banks to unnecessary default and credit risk.

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Future Performance
2.12.2 CREDIT CULTURE

This includes unique combination of policies, practices, experiences, management attitudes that together defines the lending environment and determines the lending behaviour acceptable to the bank (Taylor, 1987). Forest (2002) defined it as a system of behaviour, beliefs, style, philosophy and expression relating to the management of the credit function. Greene (1992) went further and defined it as a policy that guides credit ethic, a practice that drives lending and an audit that protects assets and credit mechanism. Banks’ hiring practices should ensure personnel are committed to strict professional ethics and comfortable in high ethical standard and behavioural environment (Fun Ho and Yusoff, 2009). This may take rewarding wanted behaviours and punishing bad or unwanted behaviours.

Mueller (1984, 1990) emphasised the importance of having a sound credit culture so as to enable
the tracking of banks’ lending strategy and objectives. In his study, he found that interactive parts of a credit culture must be in sympathy with proven principles and high standards. It must also be highly flexible to allow or adjust for change (Mueller 1993).

Swarens (1990) replicated a study by Morsman (1985) and found that credit culture has gained currency in determining the credit quality for all types of lending. In this regard, subordinates must be responsible and professional in order to prevent them from being biased when evaluating loan applications. Management must also ensure that the reward system is in such a manner that rewards good ethical practices and punishes unacceptable and flawed procedures.

2.12.3 TRAINING

Training involves the acquisition of knowledge, skills and competencies as a result of vocational or practical skills and knowledge that relates to specific useful skills. Training and development is responsible with the workplace learning to improve performance. On the job describes training that is acquired during the normal working periods, using the actual tools, equipment, documents or materials that are used in the actual environment (Farrissey, 1993). It is usually successful in vocational kind of work. While off the job training takes place away from normal work situation and the employee is considered unproductive during the training period (Fun Ho and Yusoff, 2009).

Off job training gives employees time to concentrate on the training and are most effective for training concepts and ideas. Officers should be well vested in credit law and the ability to proffer
alternative solutions to problems. Swaresh (1990) considers a fully trained loans officer to exhibit and possess superior presentation skills, good knowledge of credit law to reduce the risk of making a discriminatory mistake. He further suggested that loan officers should be able to identify solutions to a problem to ensure that customer get best advice and service. Ethical standards and behaviour among subordinates can also be enhanced by training and promotional opportunities.

Morsman (1985) reinforced this by suggesting that managers must learn from past mistakes and must be equipped with skills and knowledge to fully understand the key issues in loan administration. Farrissey (1993) posits a training program for Community banks to be structured in a manner as to curb rampant cases of imprudent lending and he provided the following programs: financial statement analysis, credit information exchange, credit reports, loan documentation as key competencies required in loan administration.

2.12.4 CREDIT REMINDERS

Whenever a borrower defaults on interest or principal repayment, a formal reminder procedure has to be initiated (Bank of Tanzania, 2010). This should be part of the credit monitoring of individual credit exposure and credit institutions arrange for automated system generated reminder that is integrated with the debtor management information system of that particular institution (Bank of Mauritius, 2004). This involves registering occurrence of default on interest or principal repayment by the Management Information System. A collection letter or a message should then be automatically sent to the borrower’s contact address, electronic mail or cellphone (Tetteh, 2012). The length of waiting period has to be stipulated in the internal guidelines and
implemented in the systems (State Bank of Pakistan, 2010). This ensures that collection platforms are sent out in time and alarm system approximately triggered (Fun Ho and Yusoff, 2009). Reminders thus serve as collection tools and if effectively used can minimise default rate.

2.12.5 DIVERSIFICATION

This usually involves spreading investments into a broader trade of financial services or loans for example business, salary based, cluster, mortgage loans to name them. Diversification reduces risk exposure and allows for more consistent performance under a wider range of economic conditions. According to Stanford (1985), diversification has the potential to reduce risk rapidly. Total risks of loan provision fall as a variety of loan products and borrowings from different industries increase, assuming the correlation between markets is not perfect. He concluded that regulation provides safety and ensures soundness of the banking system.

Swarens (1990) also found that diversification by product line can be achieved by offering a wide variety of lending services. Wyman (1991) supported that bank lending is basically a risky business but as long as banks have systematic strategy to measure linkages and co-variances among industries and region, they shall be able to maximise their return at an acceptable level of risk.

2.12.6 RISK MITIGATION

It encompasses a variety of techniques for loss prevention, loss control and claims management. Risk mitigation program is aimed at preventing losses and reduce the cost of losses while creating a safer environment for businesses. Banks use a number of techniques to mitigate the
credit risks to which they are exposed. Exposures may be collateralised by first priority claims with cash or securities. A loan exposure may be guaranteed by third party, or a bank may even purchase credit derivatives to offset various forms of credit risk (Fun Ho and Yusoff, 2009). A study by Bloomquist (1984) reckons that loan portfolio risk can be reduced with an effective credit review of applicants and selective asset backing. Thus when creditor have extensive rights to repossess collateral assets, there is stronger possibility that they can reduce their risks of losses and borrowers will be more responsible to pay when their assets are at stake.

Bloomquist (1984) figures that loan portfolio risk can be reduced with an effective credit review of applicants and selective asset backing. When creditors have extensive rights to repossess collateral assets, there is stronger possibility that they can reduce their risks of losses on one hand and borrowers will be more responsible to pay when their assets are at stake (Fun Ho and Yusoff, 2009). Though, collateral is not substitute for ability to repay, it is a common practice among financial institutions to demand that borrower provide collateral as a risk mitigation measure (Mataruke and Jubenkanda, 2005). The collateral may be difficult to realise or may even fail to cover the debt after its sequestration in the event of default.

**2.13 SOURCES OF CREDIT / DEFAULT RISK**

The process of advancing credit is associated with many risks that financial institutions have to deal with (Fun Ho and Yusoff, 2009). Basically there are many sources of credit risk factors, which include both external and internal risk factors as will be explained in the following sections (Ibid). The latter factors should be identified and any deficiencies should be dealt with first as they are within the control of the lending institution.
2.13.1 ECONOMIC CONDITIONS

Change in national income and unemployment will have impact on credit risk through change in business cycle, exchange rate, interest rate, credit availability and credit (Fun Ho and Yusoff, 2009) quality. Liquidity crunch or financial problems has the ability to impact borrowers’ ability to fulfil their obligation. In addition, legal and regulatory change could cause financial institutions to change how they oversee a transaction, as well as the quality and ability of debt collection (Eastern Caribbean Central Bank, 2009). Whilst this is a potential source of default risk, this can be taken care of if staffs responsible in credit processes or cycles are highly skilled, experienced professionals and the credit policy and procedures are highly observed.

2.13.2 FAILURE TO MEASURE CREDIT RISK

The Monetary Authority of Singapore (2003) posits that, if you cannot measure credit risk, then you cannot manage risk. The measurement of credit risk is of paramount importance in credit risk management. Davies and Kearns (1992) reinforced the idea of measuring risk when he encouraged institutions to put into practice procedures for measuring their overall exposure to credit risk as well as exposure to connected parties, products, customers and economic sectors. A well-structured internal risk rating system goes a long way in facilitating the determination of the obligor’s risk profile and likely loan loss, (Bhatia, 2005). Internal risk rating is therefore, an important tool for monitoring and controlling risk inherent in individual and portfolio credits of a bank or a business line.

2.13.3 UNDERWRITING STANDARDS

This is a process to determine what type of, to whom, for what purpose and when credit should
be granted. Proper credit approval process should comprise proper guidelines on both form and methodology in evaluating borrowers’ credit worthiness, setting up of credit line and interest rate appropriate to borrowers’ risk and credits (Fun Ho and Yusoff, 2009). Lenient credit underwriting can incur losses to financial institutions especially when debt repayment cannot be demanded or collateral cannot be seized in time (Fun Ho and Yusoff, 2009). Many credit risks arise from deficiency in underwriting standards and credit monitoring (Pike and Neale, 2006).

2.13.4 INCOMPETENCE AND CORRUPTION OF STAFF

Credit officers who do not possess necessary expertise in the activities they are responsible for, be it credits, investment, management of problem assets or new products, can lead to poor lending practice, ineffective administration, and eventually loss to financial institutions. Each loan application document should carefully be analysed by a competent credit officer with the appropriate expertise commensurate with the size and complexity of the transaction. In addition to competence, Tay (1991) observes that even though bankers are accused of misconduct, it is difficult to prove that the negligence of management is the only cause of bank failure. Smith and Walter (1997) states that fraud causes banks to fail as happened in the case of Banco Ambrasiano bank of Italy. They add that corruption and fraud have been the general causes of bank failure. Tay (1991) also argues that deregulation, mismanagement, fraud and corruption are the major causes of bank failure.

2.13.5 MANAGEMENT INFORMATION SYSTEM (MIS)

The effectiveness of a bank’s credit risk management process is highly dependent on the quality of MIS (Bank of Tanzania, 2010). The information generated from such systems enables the
board as well as all levels of management to fulfil their respective oversight roles, including determining the adequate level of capital that the banking institution should be holding. Therefore quality and detailed timeliness of information is critical. This includes, information on the composition and quality of the various portfolios, including on a consolidated basis which should permit management to assess quickly and accurately the level of credit risk that the bank has incurred through its various activities and determine whether its performance is meeting the credit risk strategy (Basel, 1999).

It is crucial that banks have an MIS in place to ensure that exposures approaching risk limits are brought to the attention of senior management. All exposure should be included in a risk limit measurement system. The MIS should be able to aggregate credit exposures to individual borrowers and counterparties and report on exceptions to credit risk limits on a meaningful and actively basis (Bank of Malawi, 2007). Banks should have MIS in place that enable management to identify any concentrations of risk within the credit portfolio (State Bank of Pakistan, 2010).

The adequacy of scope of information should be reviewed on a periodic basis by business line managers, senior management and the board of directors to ensure that it is sufficient to the complexity of the business (Basel, 1999). Otherwise risk will increase if management does not regularly receive accurate and timely reports on credits. The reports shall comprise important information relating to underwriting process such as economic trends, change in the structure of industry, or market share, commodity price, exchange rates, including past due credits, credit concentrations, and analysis of problem loans.
2.13.6 **INAPPROPRIATE ASSESSMENT OF CREDIT QUALITY**

Tetteh (2012) argued that competitive pressure and credit growth tend to put a time constraint on getting accurate data and eventually may result accumulation of a non performing loan portfolio. Moreover, rapid growth and/or entry into new markets can tempt the management to lend without sufficient financial and economic analysis (*ibid*). Management may end up facilitating quick decision making of loan granting through the use of simple indicators of credit quality such as borrowers’ characteristics, current and expected value of collateral or support of a parent company or affiliated companies (Tetteh, 2009).

2.13.7 **NEW PRODUCTS OR SERVICES AND RISK ASSESSMENT**

Financial institutions that fail to thoroughly assess risk when introduction new products and do not install risk management system prior to launch of new products are bound to register huge nonperforming loan book (Tetteh, 2012). Rapid credit growth and heightened competition may pressure financial institutions to introduce new products and services to the market without proper testing (Tetteh, 2012). Such practice can lead to bank failures as is not in line with the principle of proper credit underwriting (Eastern Caribbean Central Bank, 2009). Consequently, financial institutions should give prominence to testing of new products and services before introducing them to the market as panacea to maintain a good credit quality portfolio.

2.13.8 **SUBJECTIVE DECISION MAKING**

Subjective decision making by management happens especially when the borrower appears to have met the credit approval criteria (Tetteh, 2012). However, subjective underwriting without
proper consideration on supporting data can lead to credit risk. Credit approval over the limit or overriding the policy is another factor contributing to credit risk (Eastern Caribbean Central Bank, 2009). In addition, the beneficiaries of these credits are usually related to senior management such as the companies owned by or affiliated with the management, friends or persons with unverified financial standing or celebrities (Tetteh, 2012). Maintenance of credit quality should then depend on prudent credit underwriting which should also be in sympathy with the policy. Credit overrides is highly unadvised and may lead to high default rate (Tetteh, 2012).

2.13.9 LENDING OVER AND ABOVE THE VALUE OF COLLATERAL

When credits are granted for purchasing or developing assets that are used as collateral, many financial institutions cannot assess the correlation between borrowers’ financial condition and income generating ability and price changes and liquidity of the market for the collateral (Tetteh, 2012). These types of credits such as commercial credits, hire purchase, factoring, and commercial real estate lending reveal high correlation between credit worthiness of borrowers and the quality of asset placed as collateral (Mwisho, 2001). This is because the borrowers’ income stream deteriorates, due to economic problems and the value of the asset placed as collateral is likely to decline (Tetteh, 2012). However, collateral should only serve as a fall-back position to the lender should primary sources of income falls to repay the loan not as substitute for ability to repay (Mataruke and Jubenkanda, 2005).

2.13.10 POLITICAL FACTORS
Politically motivated or directed lending leads to bank failures as dishonest and greedy politicians exploit the funds of banks as happened in the Philippines in the 1980s (Tetteh, 2012). In most cases governments direct banks to give loans to certain borrowers, thus discouraging banks to fully make credit appraisals. The implication is that such loans are not paid off.

2.13.11 UNEMPLOYMENT

An increase in unemployment leads to an increase in non-performing loans and a decrease in unemployment leads to a decrease in non-performing loans. This is so because an increase in the unemployment in the economy will negatively affects the incomes of the individuals which in turn increase their debt burden. This is true because once a person losses his source of income this will basically affect his loan repayment capacity. Increased unemployment also negatively affects the demand of the products of firms which eventually affects the production or sales of the firms, the end result is decline in revenues of the firms and a fragile debt condition (Louzis et al, 2010) there is abundant empirical evidence to support the above association (Nkusu, 2011; Vogiazas and Nikolaidou, 2011; Bofondi and Ropele, 2011; Bege and Baye, 2007; Gambera, 2000).

2.13.12 NEGLIGENCE OF BUSINESS CYCLE

Credits granted without taking into account of business cycle can cause an overly optimistic credit analysis (Tetteth, 2012). For example, businesses such as retail business, commercial real estate, real estate investment, and consumer lending tend to have strong cyclical effects. Important to note is that there is inverse relationship between repayment difficulties and business cycle that is during contraction in business activities, there is a rise in problem accounts (Fiedler,
1971). Nevertheless, the effect of business cycle is less than the effect of product cycle, especially new, rapidly growing products such as business related to telecommunication. Effective stress testing that incorporate the effect of business cycle and product cycle is one approach for credit decision process and should induce clearer understanding in credit risk (ibid)

2.13.13 CREDIT REVIEW
Independent and on-going credit review with accurate credit grading, appropriate amount and scope, and reporting to the management comprise good credit review since it allows financial institutions to monitor risk management and solve credit problems in an appropriate and timely manner (Bank of Mauritius, 2003). Such continuous review in credit will prevent loss from failure of borrowers or counterparties to fulfil their obligations.

2.13.14 LENDING IN EXCESS
Lending in excess of the minimum required imposes risk. Lending in excess of borrowers’ ability to repay will result in problem loans (Tetteh, 2012).

2.13.15 SELF-DEALING / INSIDER LENDING
Self-dealing can cause serious problems to financial institutions, resulting in failure of financial institutions. Such practices can be found in the form of excessive credits to insiders, overriding the specified credit policy, and use of authority to improperly obtain credits without proper credit analysis, making it difficult for credit officers to appropriately assess the credits. Sometimes, insiders may apply for credits in the name of unrelated parties, inorder to conceal the self-dealing transactions. According to Brownbridge (1998), many bank failures were caused by majority of
shares held by one man or one family while managers lacked sufficient independence from interference by owners in operational decisions. A more diversified ownership structure and a more independent management might be expected to impose greater constraints on insider lending, because at least some of the directors would to lose more than they gained from insider lending while managers would not have wanted to risk their reputation and careers (Ibid).

2.13.16 LACK OF PROPER SUPERVISION

Part of credit risks arise when financial institutions’ boards or management cannot oversee various units to ensure that they appropriately comply with the policy. Undoubtedly all banks in the present-day volatile environment are facing a large number of risks such as credit risk, liquidity risk, foreign exchange risk and interest rate risk, among other risks which may threaten a bank’s survival and success. According to The Monetary Authority of Singapore (2003), banking is a business of risk. For this reason efficient risk management is absolutely required. Carey (2001) indicates that risk management is more important in the financial sector than in other parts of the economy. The purpose of financial institutions is to maximise revenues and offer the most value to shareholders by offering a variety of financial services and especially by administering risks.

2.14 CREDIT POLICIES AND PROCEDURES MANUAL

The policies would serve to guide those whose work has to do with management of credit risk in financial institutions. Walraven (1993) observed that it is prudent for banks to come up with a comprehensive credit policy manual to provide lending policy guidelines and to define the responsibilities and authority of all bank personnel engaged in the extension of credit to the bank’s customers. Consequently, the manual should reflect the bank’s lending philosophy and
strategy on major issues related to credit extension. Walraven (1993) advises that each bank has had to construct its own manual, reflecting the economic, political and geographic sectors in which its lending activities take place. The manual has to cover the entirety of the bank’s branch network.

As the manual contains a bank’s lending strategies and procedures, it should be always be considered a confidential document and as such its distribution has to be restricted exclusively to lending officers, bank managers and other individuals in areas supporting the lending function. In order to ensure confidentiality, manuals should be numbered, requiring each recipient to sign upon receipt and required to return the copy upon transfer to a non-lending related position or departure from the bank. At all times and as far as possible, manuals should be kept under lock and key in file cabinets or locked desk drawers. The distribution of the manual should reside within the Credit Policy or Risk department which includes credit experts who may be former lending officers (Mataruke and Jubenkanda, 2005). Because the policy is a live document, it should be periodically reviewed at least annually to ensure that it remains effective, flexible and continues to meet the institution’s objectives (Eastern Caribbean Central Bank, 2009).

The credit policy as recommended by Eastern Caribbean Central Bank (2009) should specify among other things the following issues:

- A credit risk philosophy governing the extent to which the institution is willing to accept credit risk;
- Levels of authority to approve credits. Delegated credit authority should be subject to timely review to ensure that it remains appropriate to current market conditions and
expertise of credit officers;

- Target markets;
- Types of facilities to be offered along with ceilings, pricing, profitability, maximum maturities and debt-service ratios of borrowers for each type of lending;
- Criteria and procedures for granting new credits, unsecured credits and for credit restructuring and refinancing;
- The minimum information required from loan applicants (considering anti-money Laundering and Know Your Customer best practices and legal requirements);
- Loan review procedures, including a grading / rating system;
- Types of acceptable collateral and the criteria for accepting guarantees;
- Guidelines for classification, provisioning and write offs;
- Guidelines for obtaining and reviewing appraisals of real estate and other collateral;
- Guidelines for related party transactions including limits for exposure to a borrower or group of related borrowers.

Given the formidable SMEs sector within the Eastern Caribbean countries, it appears a sound credit policy that contains the above specification if adequately and effectively implemented is critical in controlling credit risk and collecting from problem credits.

2.15 RISK MANAGEMENT FRAMEWORK

According to the State Bank of Pakistan (2010), risk management framework encompasses the scope of risks to be managed, the process, procedures to manage risk, roles and responsibilities of individuals involved in risk management. The framework according to them should be
comprehensive enough to capture all risks a bank is exposed to and have flexibility to accommodate any change in business activities. Key elements of effective risk management framework include active board and senior management oversight, adequate policies, procedures and limits, adequate risk measurement, monitoring and MIS and comprehensive internal controls (Bank of Malawi, 2007). The Bank of Tanzania (2010) offered the same key elements of effective risk management as that of Bank of Malawi (2007). The financial setting these countries and their level of economic development share some similarity with that of Zimbabwe as such the four elements can as well be applicable to financial institutions within Zimbabwe.

2.15.1 ACTIVE BOARD AND SENIOR MANAGEMENT OVERSIGHT

Boards of directors should approve the overall business strategies and significant policies of their institutions, including those related to managing and taking risks and should also ensure that senior management is fully capable of managing the activities that their institutions conduct as they have ultimate responsibility for the level of risk taken by their institutions (Bank of Tanzania, 2010).

Directors should have clear understanding of the types of risks to which their institutions are exposed and should receive reports that identify the size and significance of the risks in terms that are meaningful to them. They should also take steps to develop an appropriate understanding of the risks their institutions face through briefings from auditors and experts external to the institution. Using this knowledge and information, directors should provide clear guidance regarding the level of exposures acceptable to their institutions and have the responsibility to ensure that serious management implements the procedures and controls necessary to comply with adopted policies.
Senior management is responsible for implementing strategies in a manner that limits risks associated with each strategy and that ensures compliance with laws and regulations on both a long-term and day to day basis. As such management should be fully involved in the activities of their institutions and possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls and risk monitoring systems are in place and that accountability and lines of authority are clearly delineated.

Senior management is also responsible for establishing and communicating a strong awareness of and need for effective internal controls and high ethical standards. This responsibility requires them to have a thorough understanding of banking and financial market activities and detailed knowledge of the activities their institution conducts, including the nature of internal controls necessary to limit the related risks.

The State Bank of Pakistan (2010) emphasized the need to keep policies in line with significant changes in internal and external environment and Board of Directors (BOD) are expected to review these policies and make appropriate changes as and when deemed necessary. While a major change in internal or external factor may require frequent review, in absence of any uneven circumstances it is expected that BOD re-evaluate these policies (Ibid).

2.15.2 POLICIES, PROCEDURES AND LIMITS

Directors and senior management of financial institution should craft their risk management policies and procedures to be in line with risks that are peculiar to the activities of their
institutions. Once risks are properly identified, the institution’s policies and its procedures provide detailed guidance for daily implementation of broad business strategies and generally include limits designed to shield the institution from excessive and imprudent risks (Eastern Caribbean Central Bank, 2009). The policies and procedures should be regularly modified or reviewed to address significant changes in the institution’s activities or business conditions. According to the Bank of Tanzania (2010), to maintain adequacy in the institution’s policies, procedures and limits, the following should be taken care of:

- Policies, procedures and limits should provide for adequate identification, measurement, monitoring and control of the risks posed by its significant activities;
- Policies, procedures and limits should be consistent with complexity and size of the business, the institution’s stated goals and objectives and the overall financial strength of the institution;
- Policies should clearly delineate accountability and lines of authority across the institution’s activities and;
- Policies should provide for the review of activities new to the institution to ensure that the infrastructure necessary to identify, monitor and control risks associated with an activity are in place before the activity is initiated.

2.15.3 RISK MEASUREMENT, MONITORING AND MANAGEMENT INFORMATION SYSTEMS

Effective risk monitoring requires institutions to identify and measure all material risk exposures. It must be supported by information systems that provide senior managers and directors with timely reports on the financial condition, operating performance and risk exposure of the
institution as well as with regular and sufficiently detailed reports for line managers engaged in
the daily management of the institution’s activities (Bank of Malawi, 2007). Banks should have
risk monitoring and MIS in place that provide directors and senior management with a clear
understanding of the institution’s positions and risk exposures (Bank of Mauritius, 2004).

According to the Bank of Tanzania (2010), to ensure effective measurement, monitoring and
MIS, the following should be observed:

- The institution’s risk monitoring practices and reports to address all of its material risks;
- Key assumptions, data sources and procedures used in measuring and monitoring risk are
  appropriate and adequately documented and tested for reliability on a regular basis;
- Reports and other forms of communication are consistent with the institution’s activities,
  structured to monitor exposures and compliance with established limits, goals or
  objectives and as appropriate, compare actual and expected performance and;
- Reports to management or to directors are accurate and timely and contain sufficient
  information for decision makers to identify any adverse trends and to evaluate adequately
  the level of risk faced by the institution.

2.15.4 INTERNAL CONTROL

The State Bank of Pakistan (2010) identified the internal control structure as critical to the safe
and sound functioning of risk management system. Establishing and maintaining of an effective
system of controls, including the enforcement of official lines of authority and the appropriate
separation of duties such as trading, custodial and back office is one of the management’s most
important responsibilities (Bank of Tanzania, 2010).
 Appropriately segregating duties is a fundamental and essential element of a sound risk management and internal control system, failure to implement and maintain an adequate separation of duties can constitute an unsafe and unsound practice and possibly lead to serious losses or otherwise compromise the financial integrity of the institution, serious lapses or deficiencies in internal controls, including inadequate segregation of duties, may warrant supervisory action (*ibid*).

When a properly structured, a system of internal controls promotes effective operations and reliable financial and regulatory reporting, safeguards assets and helps to ensure compliance with relevant laws, regulations and institutional policies. Internal controls should be tested by an independent internal auditor who reports directly either to the board of directors or its audit committee (Bank of Tanzania, 2010).

Given the importance of appropriate internal controls, the results of audits or reviews, whether conducted by an internal auditor or by other personnel should be adequately documented as should management’s responses to them. According to The State Bank of Pakistan (2010) to ensure adequacy to an institution’s internal controls and audit procedures, the following should be observed:

- the system of internal controls should be appropriate to the type and level of risks posed by the nature and scope of the institution’s activities;
- the institution’s organisational structure should establish clear lines of authority and responsibility for monitoring adherence to policies, procedures and limits;
- reporting lines should provide sufficient independence of the control areas from the business lines and adequate separation of duties throughout the institution such as those relating to trading, custodial and back-office activities;
- official institutional structures should reflect actual operating practices;
- financial, operational and regulatory reports should be reliable, accurate and timely, wherever applicable exceptions should be noted and promptly investigated;
- internal audit or other control review practices should provide for independence and objectivity; and
- Internal controls and information systems are adequately tested and reviewed, the coverage, procedures, findings and responses to audits and review tests are adequately documented. Identified material weaknesses are given appropriate and timely high level attention and management’s actions to address material weaknesses are objectively verified and reviewed.

2.16 CREDIT REFERENCE BUREAU (CRB)

According to Sinare (2008), CRB are information brokers, providing creditors with reliable, relevant and comprehensive data on the repayment habits and current debt of their credit applications. CRB obtain data from creditors and other sources, consolidate and package information into individual reports and distribute it to creditors for a fee (Wanjiru, 2013). Such information includes credit history, identity, credit amounts and loans, bankruptcies and liquidations, late payments, recent inquiries, proven frauds and forgeries, cheque kiting, false declarations and statements, receiverships, credit default, use of false securities and misapplication of borrowed funds (Ibid). Lewis (2004) indicated that most banks and most
creditors prefer hard collateral-based credit but would extend cash flow-based credits if they can use a reliable and inexpensive system to exchange information on the character and ability to pay of borrowers.

The need for establishment of CRB services in any financial system arises because of information asymmetry between lenders and borrowers (Paydaycash, 2010). When financial institutions compete with each other for customers, multiple borrowing and over-indebtedness increases loan default unless the financial institution have access to databases that capture relevant aspects of clients’ borrowing behaviour (Wanjiru, 2013). In this respect, CRB contributes significantly to reduction in the costs of screening loan applications by enabling the lender to sort out prospective borrowers who have defaulted with other lenders.

According to Wanjiru (2013), the individual information collected by CRBs is made available on request to customers of the credit bureau for the purposes of credit risk assessment, credit scoring or for other purposes such as employment consideration or leasing an equipment. The CRB plays important roles, firstly by enabling lenders to lend to more and better risk clients and to determine better and/or lower the bad loan spread that they need to cover expected losses of credit to good payers. It also reduces the borrowing cost by forcing creditors to be more competitive for good borrowers. Those lower costs for good credit risks motivate those borrowers to be more careful with repayment. CRB also reduce moral hazard by developing a credit culture where they operate as borrowers become aware that credit market becomes aware of their credit history and rewards or punishes them accordingly (Sullivan and Sheffrin, 2003).
CHAPTER SUMMARY

Chapter two reviewed and analysed literature on credit risk management, origination of borrower and creditor relationship, role of credit, forms of credit, risk management processes, credit risk management process and cycles, asymmetric information, discouraged borrowers, factors of credits, sources of credit risk, credit policies and procedures manual, risk management framework and credit reference bureau. The following chapter is going to focus on the research design and research methodology which the researcher used during the research process.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter outlines the research methods that were used to gather and analyse data collected during the course of the study in an attempt to uncover the research problem. An evaluation of the strengths and limitations of the research methods that were applied in this study would be made. This chapter specifically focused on the research design, research subjects, research instruments, data collection procedures, data presentation and analysis.

3.2 RESEARCH METHODOLOGY

Lindlof (1995) defines methodology as a strategy, which links the goal of the study to the type range and sequence of methods in the gathering and analysis of data. Seliger and Shohammy (1989) stated that, “in collecting data, it is important to use procedures that elicit high quality data since quality of study depends largely on the quality of data collected and the quality is directly related to data collecting procedures.” Haralambos and Holborn (1989) echo the same
sentiments when they assert that, “any academic subject requires methodology to reach its conclusions. It must have ways of producing and analysing data so that theories can be tested, accepted or rejected”. It is widely agreed that without a systematic way of producing knowledge, the findings of a subject can be dismissed as guess work or even as common sense.

Methodology is indeed an important aspect of research processes. Smith (1998) defines methodology as the research techniques that are most suitable for studying a phenomenon or phenomena. It represents ways by which researcher act on their environment, that is, their methods of conducting research. Paterson (1982) further augments this when he refers to methodology as “a particular procedure of doing things or operations framework within which facts are placed so that their meaning may be clearly seen.” In view of these sampled definitions, the researcher would give a brief but clear description of how the research exercise was executed, highlighting the methods that were used to obtain data, research instruments used and data collection techniques employed.

There are two broad categories of research methodologies, that is, qualitative and quantitative research. Qualitative research is explanatory while quantitative is conclusive (Zikmund, 2003). Quantitative research is measurable while qualitative data cannot be put in a context that can be graphed or displayed as a mathematical term but can only be discussed. Qualitative research entails collecting, analysing and interpreting data by observing what people do and say. It refers to the meanings and description of things. According to Linderman (1992), quantitative is simply about numbers and objective hard data.
Realising the strengths of both approaches and with the intent to enrich the research by striking a balance, the researcher used both approaches. De Vos (1998) supports this when he observed that using both approaches helps in developing the research, that is, one approach is used to inform the other.

3.3 RESEARCH DESIGN / PLAN

Mcillan and Schumacher (1993) note that, “a research design refers to the plan and the structure of the investigation used to obtain evidence to answer research questions”. According to Kumar (1999), research design is a procedural plan that is adopted by the researcher to answer questions validly, objectively and accurately. In simpler terms it is a plan of what data to gather, from who, how and when to collect the data and how to analyse the data obtained to address the central research questions. The correct design could result in gathering valid and reliable data.

3.4 RESEARCH PHILOSOPHY

Research philosophy is divided into three paradigms namely positivism, critical theory and realism. Positivism paradigm views observations and reasons as the best means of understanding human behaviour and reality is assumed to be objectively given and measurable using properties which are independent of the researcher and his or her instruments (Guba and Lincoln, 1994). Such a paradigm adopts scientific methods and systematise the knowledge generation process with the help of quantification to enhance precision in the description of parameters and the relationship among them.
Its main disadvantage is that knowledge is never abstract, objective and absolute, but is always concrete situated and tied to human practice (Gergen, 1982). Gergen further noted that scientific procedure often suppresses the element of negotiation and prevents the researcher from investigating its character. The testing of hypotheses becomes to a certain extent, self-fulfilling over time as they shapes that towards which the attention is directed and people react interactively in testing situations.

Critical theory assumes reality to be comprehensible and to have been shaped over time by social, political, cultural, economic, ethnic and gender factors to create structures that are seen as normal or real. It assumes that social reality is the product of history and that it is produced and reproduced by people (Myers, 2009). The investigator and the investigated object are assumed to be interactively linked with the values of the investigator inevitably influencing the inquiry. In fact, the researcher cannot separate himself from his environment or what he researches which in turn influences what he knows.

Realism paradigm is where reality is assumed to exist but to be only imperfectly apprehendable because of basically flawed human intellectual mechanisms and the fundamentally intractable nature of phenomena (Guba and Lincoln, 1994). The researcher’s ability to know this reality is imperfect as it is known through his or her own perspective. This research adopted the latter two as this area of study involves too much human views and interpretations which are usually shaped by their difference past experiences.
3.5 RESEARCH STRATEGY

According to Saunders et al (1997), a research strategy is a general plan about how one goes about answering the research questions. The strategy should indicate objectives, sources of data and constraints which inevitably would be experienced. Crucially, the strategy should indicate why the research has chosen a particular strategy. Borg and Gall (1989) point out that there are a number of research strategies which include descriptive survey, grounded theory, action centred research, ethnography, experimental designs correlation research, historical research design and case study design. In terms of time horizon, there are longitudinal and cross sectional time scales that are used in research work. The strategy that was used in this research is descriptive and case study methods. The survey method would be adopted to collect data and is considered appropriate as it could make use of different research instruments like questionnaires, interviews and document analysis.

3.6 RESEARCH PURPOSE

Exploratory, descriptive, causal, explanatory and correlation research forms part of the research purpose.

3.6.1 EXPLORATORY RESEARCH

Exploratory research is a valuable means of finding out what is happening, seek new insights and assess phenomena in new light (Robson, 1993). This research design gives the researcher ideas and insights about broad and vague research problems. Such designs allow a more precise statement of the problem to be formulated which in turn will allow causal or descriptive research designs to be used. Emory and Cooper (1991) suggest the three following ways of conducting
exploratory research:

- A search of the literature
- Talking to experts on the subject
- Conducting focus groups interviews

The exploratory research design was considered appropriate for this particular research as it would result in specific conclusions on the extent to which DFIs can manage credit risk.

### 3.6.2 DESCRIPTIVE RESEARCH

Robson (1993) noted the objective of a descriptive research as to portray an accurate profile of persons, events or situations. It is designed to determine the frequency with which something happens or the extent to which two or more variables are related. It helps to provide answers to such questions like who, what, when, where and how of a topic. However, it should be noted that descriptive research designs do not attempt to uncover the question “why” certain relationships exist (Van Der Walt et al, 1997).

### 3.6.3 CAUSAL RESEARCH

In causal research, the researcher attempts to establish the cause-and-effect relationship that exists between variables. The approach seeks to establish the extent to which changes in one variable causes changes in the other variables. It is mainly used when the objective of the research is to assess cause-and-effect relationship among variables (Madden and Furtle, 1994). The approach is inappropriate for this research because it is difficult to create cause-and-effect relationships that are relevant to the research questions.

### 3.6.4 EXPLANATORY RESEARCH
Saunders et al (1997) assert that explanatory research is a study which seeks to establish causal relationships between variables. This research design answers the question how and why an intervention works. The research design is valuable for understanding questions of efficacy but is of limited value for defining whether to provide a service to a wide variety of variables in a wide variety of circumstances. The method explains a particular phenomenon.

3.6.5 CORRELATION RESEARCH

The research examines the relationship between variables. The strength and direction of the relationship is described by the coefficient of correction which ranges from +1 to -1. This approach involves manipulation of one or more independent variables to see their extent of influence on the dependent variable. In this research, there are no specific relationships expected to come out.

3.7 SAMPLING FRAME

The sampling frame must be representative of the population. As Hopkins (2000) argues, sampling frames omit some people who will vote at the next election and contain some people who will not. People not in the sampling frame have no prospect of being sampled therefore a sampling frame for Doodley (1998) must be representative of the population and this is outside the question of the statistical theory demanding the judgement of experts in the particular subject matter being studied. A frame therefore represents the boundary from which the sample is going to be selected. For the case of this study the sample frame will consists of SEDCO senior management, Branch Managers, Business Analysts, Portfolio Controllers, senior loans officers
from three local banks and SMEs who benefitted from SEDCO financial support between 2009 and 2012. Since employees are all from SEDCO, this will make their accessibility by the researcher easy as he is part of them.

3.7.1 SAMPLING METHODS

Sampling is a statistical practice concerned with the selection of individual observations intended to yield some knowledge about a population of concern especially for the purpose of statistical inference. Searle (1995) define sampling as, “the selection of units of analysis such as people or institutions for study.” The idea is about selecting a few (a sample) from a bigger group (sampling population) to become the basis for estimating or predicting a fact, situation or outcome regarding the bigger group.

As William et al (2002) explains ‘If the aim of a certain study is to learn things about a certain population, the optimum methodology is to test all members of that population but however, as a rule you simply cannot do this since it can be prohibitively time consuming, expensive and ultimately pointless’.

Sampling is therefore the process of selecting units from a population of interest so that by studying the sample one can fairly generalise the results back to the population from which they were chosen. However, although sampling is cost effective, it has the most apparent limitations of determining the population involved and how to estimate value from a sample. Myers (2009) point out that unconscious bias exist as researchers tend to approach friendly people, and classifying people before approaching them. Within this scope of study the population refers to SEDCO employees, loan beneficiaries and senior loans officers from local banks.
3.7.1.2 PROBABILITY SAMPLING / RANDOM SAMPLING
Probability sampling is a sampling technique wherein the samples are gathered in a process that gives all the individuals in the population equal chance of being selected. In this sampling technique, the researcher must guarantee that every individual has an equal opportunity for selection and this can be achieved if the researcher utilises randomisation. However, Henry (1990) advises against probability sampling for population of less than 50. He argues that one should collect data on the entire population as the influence of a single extreme case on subsequent statistical analysis is more pronounced than for large samples.

If random selection is done properly, the sample will be representative of the entire population. The advantage of using a random sample is minimal or absence of systematic bias which is the difference between the results from the sample and the results from the population. Sampling bias is also eliminated since the subjects are randomly chosen. However this sampling approach is not always desirable or practical. For example, probability sampling is not necessary when a researcher wishes to describe a particular group or action in an exploratory way.

3.7.1.2.1 SIMPLE RANDOM SAMPLING
Wrights (1986) states that, “simple random sampling is one of the basic types of probability samples, in which each unit in the population has an equal chance of being included in the sample.” It is suitable when the population consists of large units. Best and Khan (1993), defines a population as the “aggregate of individual units or elements of analysis from which a study sample is actually chosen. One major advantage of this method is that it will very likely result in a sample which is representative of the population. With any sampling there is a risk that the sample may not adequately represent the population but with random sampling the risk is
quantified and thus an appropriate sample size is chosen. It requires that the researcher has a list of the objects under study, and will choose them randomly. A random sampling method ensures that each element has an equal and independent chance of being selected to take part in the research. This type of sampling will not be applied in this study as it could end up including employees whose functions have nothing to do with credit risk management issues.

3.7.1.2.2 STRATIFIED RANDOM SAMPLING
In this method, the entire population is divided into exclusive sub-groups or strata and then units are selected randomly from each stratum. The segments are based on some pre-determined criteria. The approach involves the proportional allocation of sample size to each segment. Other sampling techniques such as simple random sampling can be applied after the strata have been established.

3.7.1.2.3 SYSTEMATIC SAMPLING
When using this method, samples are drawn by starting at a randomly selected element in the sampling frame and then systematically selecting respondents in a fixed interval of random numbers. This sampling technique is most suitable for a sample whose members consist of the same characteristics and attributes.

3.7.1.2.4 CLUSTER SAMPLING
Henry (1990), states that on the surface, cluster sampling is similar to stratified sampling as the researcher needs to divide the population into discrete groups prior to sampling. Cluster sampling is a two-stage sampling technique. Firstly, the population is grouped into clusters and some of these clusters are randomly selected for study. The method has the advantage that one does not need a sampling frame for the entire population but only for the selected clusters which reduces administrative costs. Cluster sampling is most suitable where natural groupings are evident in the
population.

### 3.7.1.3 NON-PROBABILITY SAMPLING /NON-RANDOM SAMPLING

Non-probability sampling is a sampling technique wherein the samples are gathered in a process that does not give all the individuals in the population equal chances of being selected (www.experiment-resources.com). In this sampling approach, the population elements are selected on the basis of their availability or because of the researcher’s personal judgment. The consequences are that an unknown portion of the population is excluded. Non-probability sampling provides a range of alternative techniques based on one’s subjective judgment (Saunders et al, 1997). The most common types of non-probability sampling are convenience, purposive and quota sampling.

#### 3.7.1.3.1 CONVENIENCE SAMPLING

The samples are drawn from units that are conveniently available, which explains why it is also called availability sampling (Hsia; 1998). It is a method of choosing items in an unstructured and arbitrary manner from the frame. This method is convenient because the units drawn are available. For this study, the sample comprised respondents who were available in a convenient way to the researcher and the selection of material that the researcher deemed suitable. This method will be applied in choosing employees to respond to questionnaires as well as to be interviewed. It is deemed to be feasible in terms of time and resources. However, there will be no randomness and therefore likelihood of bias is bound to be high. The researcher applied this sampling method in choosing loan beneficiaries to interview.

#### 3.7.1.3.2 PURPOSIVE SAMPLING
Franklin (2000) states that, “purposive sampling is a non-probability method in which units (employees) are selected instinctively and then an attempt to obtain a sample that appear to be representative of the population is made. It is used in situations where the researcher needs to reach a targeted sample quickly. It will be employed in choosing the employees that will be interviewed in this research. Patton (1990) asserts that, “purposive sampling ensures that subjects are selected because of some homogenous characteristics, in this case Branch Managers, Business Analysts and Portfolio Controllers are all involved in lending activities. Three local banks to represents other banks were selected using this sampling method and the senior loans officers to be interviewed thereof.

A researcher thus has to choose a suitable data collection method that will come up with the best results that can be easily measured both quantitatively and qualitatively. As such purposive sampling was deemed advantageous because it was easy to obtain relevant information and there was no wastage of resources in collecting data that was not relevant to the study. However, the subjectivity involved in purposive sampling means that the researcher has to be proficient in influencing the outcome.

3.7.1.3.3 QUOTA SAMPLING

According to Barnett (1991), quota sampling is entirely non-random and is normally used for interview surveys. The population is divided into segments and a quota of observation is collected from each segment. It involves the segmentation of the population into mutually exclusive sub-groups just as in stratified sampling. The researcher will then use judgment to select elements from each group or segment based on a specified proportion. The selection of the
sample is non-random and the sample may be biased because not everyone gets a chance of selection. Quota sampling is quick and cheap but its main disadvantage is that it is not representative.

3.8 RESEARCH SUBJECTS

The research population was 580, which was made up of current staff levels at SEDCO (70), loan beneficiaries (500) and senior loans officers from other local banks (10). The researcher used questionnaires, personal interviews and abstraction from records. During the research process the following sample breakdown was used.

Sample size of fifty-six is considered for this research as the research has to include only those employees whose responsibility is directly related to lending and loan administration and who are knowledgeable about risk management issues. Branch Managers and Business Analysts were considered as they are heavily involved with the credit processing, approval, documentation, administration, disbursement, monitoring and control of individual credits while the Portfolio Controllers are seized with monitoring the overall credit portfolio, classification of credit and management of problem credits. Senior and Middle level management as they are responsible for credit approval and implementation of organisational credit policies and strategies (Bank of Malawi, 2007). Industrial Development Corporation, Infrastructural Development Bank of Zimbabwe and AGRIBANK share the same character with SEDCO (they are all DFIs), hence ten senior officers at their respective Head Office were interviewed to draw lines on how each organisation handle credit risk. Ten previous loan beneficiaries in different forms of business who are in Bindura were interview as they were close to the researcher and inexpensive to reach. The loan beneficiaries had benefitted thrice from the organisation’s facilities and incorporated
companies. The sample breakdown is as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Numbers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Managers</td>
<td>6(personal interviews)</td>
</tr>
<tr>
<td>Branch Managers &amp; Business Analysts</td>
<td>21(questionnaires)</td>
</tr>
<tr>
<td>Portfolio Controllers</td>
<td>9(questionnaires)</td>
</tr>
<tr>
<td>Loan Beneficiaries (SMMEs)</td>
<td>10(personal interviews)</td>
</tr>
<tr>
<td>Senior Loans Officers from 3 local banks</td>
<td>10(personal interviews)</td>
</tr>
</tbody>
</table>

3.9 RESEARCH INSTRUMENTS

This section of the research report presented the techniques that were employed at the data gathering stage. Each method was thoroughly scrutinized so as to reveal the strengths and weaknesses of each technique. The researcher explained what he did to counter the weaknesses inherent in the technique, so the research results wouldn’t be adversely affected.

3.9.1 PRIMARY RESEARCH INSTRUMENTS

This comprises data that the researcher collected physically. It is first-hand information in its raw state. The researcher conducted interviews and administered questionnaires to gather such information, that is, employees’ opinions and views. Data was collected from employees of SEDCO (Business Analyst, Portfolio Controllers and Branch Managers), loan beneficiaries and senior managers from local banks. The most apparent advantage of using such a method is that the data collected is first hand and accurate.

3.9.1.1 SELF- ADMINISTERED QUESTIONNAIRES

A questionnaire is a set of written questions of statements that assess attitudes, opinions or
beliefs, (McMillan and Schumacher 1989). They also probe responses from respondents. There are two types of questionnaires namely those containing open-ended questions and those with closed ended questions. Open ended questions are answered from the respondent’s own words as they must think of their own responses and describe them in their own words. The researcher used closed ended questions in designing the questionnaires. In closed ended questions, respondents choose answers from a predetermined set of answers. This allowed the researcher to get information quickly that addressed the research objectives.

The questionnaire method was used for the reason that it is not time consuming in administering; respondents are at liberty to respond freely on their own time thus allowing them to mail their best responses. Anonymity of the respondents is maintained. It is important to note that the aspect of how credit risk is managed within quasi-government organisation seems sensitive and the best way is to maintain anonymity of respondents so as to obtain information without fear of victimisation. Using questionnaires was likely to cause some problems for the researcher as some respondents could not complete at the agreed time and therefore would hurriedly fill them. The researcher gave the respondents five days to fill in the questionnaires. Moreover, there might be some random ticking of answers without reading and understanding the questions thereby misleading the research. As Haralambos (1984) noted, questionnaires fail to reveal the respondent’s attitude and feelings. Some respondents might give answers just to please the researcher. The researcher made use of face to face interviews to cover up for the disadvantages of questionnaires.
3.9.1.2 FACE TO FACE INTERVIEWS

Denzin (1970) defines interviews as, “any face to face conversation whereby one person elicits information from another”. Zikmund (2003) defines personal interview as “a form of direct communication in which an interviewer asks respondents questions in a face-to-face situation”. Interviews provide the best window on how people think and feel, allowing the researcher to probe into areas that are not immediately understood (Priest 1996). Denzin (1970) state that, “an interview is an essential data gathering method which is needed in situations where detailed information is required and the respondents are basically not too many.” Since this study is qualitative in nature, the researcher used interviews to understand employee’s perspectives from their past experience so as to gain the real information on how credit risk is being managed. The researcher interviewed four Senior Managers and four Middle level Managers at SEDCO Head Office, ten previous loan beneficiaries and ten senior loans officers from 3 local banks.

There are two types of interviews, the structured and the unstructured interviews. The researcher made use of unstructured interviews to gain an insight into the views of the senior managers concerning issues to do with credit risk management within SEDCO in particular and DFIs in general. Unstructured interviews rely on open-ended questions. The researcher came up with few questions and the whole lot of questions cropped up from the questions initially asked. Unstructured interviews allowed a flow of ideas during the interpersonal relationship between the interviewer and the interviewee.

By using this type of interview, the researcher was expected to obtain unexpected information that other forms of research could not discover as follow up questions were utilised that was not
possible with questionnaires (Cohen and Manion, 1995). However, the interview method is prone to bias and subjectivity in the case of the interviewee. Worsely (1970) contends that, “sometimes when information is sensitive, respondents may become reserved thereby hampering the progress of research as they try to protect their images thus important information may be missed.” Verification of facts could be difficult.

**Advantages of Face To Face Interviews**

Several advantages can be drawn from using face to face interviews. According to Burns (2000) the response rate as responses to the questions are obtained instantly and all questions are answered. The interviewer has more control over the flow and sequence of questions.

Cohen and Manion (1995) further contend that interviews permit the researcher to ask questions that are more complex and ask follow up questions which is not possible in a questionnaire. Further information can, therefore be obtained. Interviews may permit a higher degree of confidence in the replies and can take account of non-verbal communication. Face to face interviews are also suitable where complex topics are involved or where the investigation concerns matters of a personal nature.

**Disadvantages of Face To Face Interviews**

There are some problems, however associated with interviews. Cohen and Manion (1993) identify limitations which they indicate to be inevitably different from one interview to another. Some of these are mutual trust, social distances and interview control. If mutual trust does not exist between the interviewer and the interviewee the information to be gathered may be distorted. The interviewee may withhold certain information they perceive to be sensitive. The
researcher however, built good rapport with the subject during the research process. Interviews are also expensive and time consuming.

It is time consuming in that interviews have to be arranged and a record of responses of interviews has to be kept through taking down notes. It is also expensive in that interviewing is skill which requires training. Training of interviewers is expensive. Interviews may be biased. Interviewees have certain expectations about the interview and therefore, give what they consider to be 'correct' or 'acceptable' responses. However, the researcher had gone through an intensive enumeration training with Zimbabwe Statistical Agency former Central Statistics Office some time before embarking on this research programme and was attached for two years responsible for carrying out its various surveys.

3.9.1.3 OBSERVATION

Chiromo (2006) contends that observation seeks to ascertain what people 'think or do by watching them in action as they express themselves in various situations and activities. Goode and Hatt (1994) pointed out that observation is carried out by looking at things, its purpose and the aim is to discover significant, mutual relations between spontaneously occurring events, thereby pinpointing the crucial facts of the situation.

Advantages of the Observation Method

Observation is suitable when the researcher is interested in their overt behavior. The researcher observes people as they do their business but the people should not be aware that they are being observed. The researcher notes down the observations and makes conclusions on basis of the observations made. Cohen and Manion (1996) observed that the data collected is likely to be
reliable because the subjects are observed without their knowledge. They therefore do not modify their behavior to please the researchers. No communication skills are required as there is no communication between the researcher and the subject.

**Disadvantages of the observation method**

The demerits of this method according to Burns (2000) are that special observational techniques are required. The researcher thus, requires special training in collecting data using this method. Beri (2000) also adds that the method becomes useless once the subjects recognize that they are being observed. They may change their behaviour to please the researcher. The researcher has been trained to carry out observation in one of the investment and appraisal refresher courses he attended with SADC-Development Finance Institutions Resource Centre, so he is well placed to handle observation ambiguities. To some extent, observation was used by the researcher to gather information on how problem credits are being handled since the researcher works for SEDCO. In this case observation was done during the normal course of discharging duties at the workplace.

**3.9.1.4 PARTICIPATORY**

According to Van Maanen (1995), participant observation is an essential element of fieldwork and often the only method of data collection deployed by an ethnographic researcher. The purpose of the researcher working in the field alongside research informants is to uncover accounts which may not have been accessed by more formal methods like interviews. There are four types of researcher engagement (Burgess, 1984):

- The *complete participant*, who operate covertly, concealing any intention to observe the setting;
- The *participant-as-observer*, who forms relationships and participates in activities but makes no secret of an intention to observe events;
• The *observer-as-participant*, who maintains only superficial contacts with people being studied, for example, by asking them occasional questions; and

• The *complete observer*, who merely stands back and ‘eavesdrop’ on the proceedings.

In participatory research, the researcher works with the group under investigation. The researcher takes a lead from the group on what is to be studied, where, when, and how. The researcher also shares useful research skills with the group, which would enable the group members to undertake further research autonomously (www.answers.com). The main disadvantage of this inclusive research method is that it is very difficult to reconcile the interests and priorities of all the members of the group that is why it was not considered for this study.

3.9.1.5 CASE STUDIES
Case studies usually involve detailed study of a particular case (a person or small group) (Yin, 1994). It involves measuring what is there and how it got there. Various methods of data collection and analysis are used but this typically includes observation and interviews and may involve consulting other people and personal or public records (Yin, 1994). According to Yin the researcher may be interested in a particular phenomenon and select one or more individuals in the respective situation on whom to base their case study / studies. Findings of a case study have a limitation in that they may not be replicated in a similar case study. Nevertheless, it can be useful in clinical settings and may even challenge existing theories and practices in other domains. For these reasons, the method was highly applied by the researcher as a way to explore credit risk management issues specific to DFIs.

3.9.2 SECONDARY RESEARCH INSTRUMENTS
The researcher was conscious of the importance of using secondary data sources in research work. According to Haralambos and Holborn (1990), secondary data consists of data that already exists. It comprised data as information already analysed by other scholars. The researcher utilised secondary data sources such as textbooks, journals, company publications (SEDCO Act, operations policy and procedures, risk policies and procedures) and the Internet. Secondary data sources were used to gather information on theories that informed the research and for literature review.

3.9.2.1 DOCUMENT ANALYSIS

This involves reviewing all readily available materials. The materials included internal company information, relevant trade publication, newspapers magazines and annual reports company literature to name a few. It is a very expensive method of gathering data although it generally does not yield timely data. Lancaster (2005) argues that the method is cheap as the data is readily available from previous publications and researches. There is no travelling to collect data as in interviews. It might be easier to predict the future state of affairs on the basis of the past trends. The method though has its own demerits. According to Beri (2000), the data collected might not be up to date, thus the finding and conclusions made might not be applicable to the current situations. In this investigation, documents such as journals on finance, guidelines of risk management from various Central Banks around the world, SEDCO operating policies and procedures, SEDCO Act Chapter 24 of 1984 and SEDCO credit risk policies and procedures were reviewed.
3.10 DATA COLLECTION TOOLS

3.10.1 QUESTIONNAIRES

By using the questionnaire, the researcher formulated the questions fully guided by the research objectives and questions and present them in the questionnaire format. The researcher further tested the questionnaire by conducting a pilot survey, effected all the necessary adjustments and finally distributes the tool to the targeted respondents. On agreed dates and times, the researcher collected the duly completed questionnaire copies. Thirty questionnaires were distributed to employees of SEDCO that includes business analysts, branch managers and portfolio controllers for them to respond. This was because their numbers was huge and widely dispersed within the breadth and length of the country. So questionnaires were used as it is cheaper in terms of time and cost of travelling to reach each and every respondent.

3.10.2 FACE TO FACE INTERVIEW

The interviewer made sure that he was well dressed. He further choose a sight that was quiet, private and with a pleasant environment. He planned carefully on the instructions and the questions to ask. During the interview the interviewer took note of the responses and recorded the relevant facts. Twenty eight interviews were held with senior and middle manager of SEDCO (8), loan beneficiaries (10) and senior loans officers (10) from three local banks. In view of the shortcomings of the questionnaire, there was need to confirm and complement the findings gathered through the questionnaires. Certain aspects on the questionnaires got clarified by interviews conducted with these key stakeholders.
3.10.3 OBSERVATION

The researcher identified strategic points from where he carried out some observation without asking respondents. He will take some notes as he observes the behavior and tries as much as possible to avoid the respondents so that they behave in their normal behavior so as to produce reliable results.

3.10.4 DESKTOP RESEARCH TECHNIQUE

The researcher collected relevant information from books, journals, publications from Central Banks within the globe, Acts, risk policies and procedures of financial institutions. Some information was extracted from the internet.

3.11 DATA PRESENTATION AND ANALYSIS PROCEDURES

Collected data was subjected to thorough analysis using descriptive statistics that is, graphs, tables, narratives and spreadsheets. Presentations using tables, graphs and spreadsheets made it easy for beneficiaries to understand the picture of the research findings.

A descriptive statistical method of data analysis such as pie charts, bar graphs and simple data tables was used to present the data. Upon primary data collection from respondents, the data was then analysed and presented in tabular and diagrammatic forms. Responses and value judgments were then outlined in order to summarise emerging issues and proffer recommendations. From data analysis, the researcher then discussed and interpreted the data from the perspective of research questions as outlined in Chapter one.

3.12 VALIDITY
Leedy (1997) contends that validity is concerned with the soundness and the effectiveness of the measuring instruments. Validity is primarily about how well a measuring instrument is measuring what it is supposed to measure. Silverman and Keating (2002) reports that validity is enhanced when the researcher takes certain precautionary steps: have people with diverse backgrounds and view-points review the survey before it is administered. Find out if:

- Each item is clear and easily understood
- They interpret each item in the intended way
- The items have an intuitive relationship to the study’s topic and objectives, and
- Your intent behind each item is clear to colleagues knowledgeable about the subject.

Considering these principles, the researcher asked senior loans officers at some commercial banks who have been or are currently involved in lending activities to respond to a survey response instrument and the proposed questionnaire. Responses to the instrument were grouped as follows: (1) clarity of directions (2) clarity of questions (3) relevancy of the question as an important aspect of a major issue, and (4) Narrowness or constraint of response.

Finally, the panelists were asked, ‘Are there any other issues that you think should be included in the survey’. Results of the responses and questions were collected and analysed. The survey response instruments are found in Appendix 2 and 3. The questionnaire was also reviewed and approved by the Supervisor. These procedures resulted in the questionnaire and interview guide used in this research.

3.13 CHAPTER SUMMARY

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This chapter focused on the research methodology, research design, research philosophy, research strategy, research purpose, research population, sampling frame, research subjects, research instruments, data collection tools, data presentation and analysis, research procedures and validity. The research methodology justified the quality of results of an investigation. The following chapter focused more on detailed data presentation and analysis of results.

CHAPTER IV
DATA PRESENTATION AND ANALYSIS

4.0 INTRODUCTION

The previous chapter described the methodology used in this study. It discussed the various aspects of research methodology which includes; research design, research subject, research instruments as well as data collection, presentation and analysis procedures and ended by giving a summary of the issues that had been covered. This chapter presented and analysed the data that was gathered during the course of the study. The research results came from self-administered questionnaires, document analysis and interview exercise. The results sought to exhibit the extent to which research objectives and research questions have been attended to. The researcher presented the data using descriptive statistics such as graphs, tables and spread sheets.

4.1 QUESTIONNAIRE RESPONSE RATE AND INTERVIEW SUCCESS RATE

Out of the thirty questionnaires sent to the target population, twenty-seven usable responses were collected. This represented a response rate of 90 percent and implies that 10 percent of the questionnaires were not returned at all. The face to face interviews proceeded as had been planned with six senior managers from SEDCO and 10 interviewed from other financial
institutions and 10 loan beneficiaries. Thus, the response rate for face to face interviews was 100%. In view of the high response rates for both tools the researcher went on to analyze the research findings. It is also important to note that, what was more important was a demonstrated lack of response bias than a high response rate. The results are shown in table 4.1 below.

Table 4.1: Questionnaire and interview success rate

<table>
<thead>
<tr>
<th></th>
<th>Target respondents</th>
<th>Successful</th>
<th>Success rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Questionnaires</td>
<td>30</td>
<td>27</td>
<td>90</td>
</tr>
<tr>
<td>Interviews</td>
<td>26</td>
<td>26</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research data 2014

The statistics in table 4.1 above gives a fair representation of the target population and hence the validity of data.

4.2 PROFILE OF RESPONDENTS

Table 4.2: Working position of questionnaire respondents

<table>
<thead>
<tr>
<th>Current Role</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio Controller</td>
<td>9</td>
<td>33</td>
</tr>
<tr>
<td>Business Analyst</td>
<td>10</td>
<td>37</td>
</tr>
<tr>
<td>Branch Manager</td>
<td>8</td>
<td>30</td>
</tr>
<tr>
<td>Total</td>
<td>27</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Research data 2014
Most of the questionnaire respondents were business analysts representing 37% of the total respondents. Branch managers and portfolio controllers represented 30% and 33% respectively. Their working experience is indicated in figure 4.1 below. Most of them had been with the organization for more than 4 years. Their lowest qualification was bachelors’ degree.

![Working experience in lending](image)

*Source*: Research data 2014

The results in figure 4.1 above showed the distribution of the number of people and the respective number of years they have been working for the organization. From figure 4.1 above only 11% of the total sample gathered were those who had been with the organization for just a few years. The remaining 89% had been in the organization for more than four years. This shows that the responses are coming from people who truly understand the position of their organization with regards to issues of lending.

### 4.3 DATA PRESENTATION PROCESS

The data was gathered and analysed using descriptive statistics as shown by the preceding
sections. The research findings were also compared with what had been discovered by the other researchers to indicate the authenticity of the research study.

4.3.1 LEVEL OF LOAN DEFAULT SINCE 2009

Generally loan default rate within SEDCO has been increasing since 2009 as depicted in the Table 4.3 below.

**Table 4.3: Trend of loan default**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loan (US$000)</td>
<td>600</td>
<td>1,600</td>
<td>2,600</td>
<td>3,500</td>
</tr>
<tr>
<td>Loan Default (US$000)</td>
<td>78</td>
<td>272</td>
<td>598</td>
<td>1,085</td>
</tr>
<tr>
<td>Ratio of loan default to total loans (%)</td>
<td>13</td>
<td>17</td>
<td>23</td>
<td>31</td>
</tr>
</tbody>
</table>


The total loan book of the Corporation increased from US$0.6 million in December 2009 to US$3.5 million in December 2012. Interview respondents attributed the upward trend in default levels to growth of the organization’s loan book since 2009 as depicted in table 4.3 above. The significant increase in the ratio of loan default to total loans from 17% in December 2010 to 31% in December 2013 was mainly attributed to growth in unsecured lending they referred to as group lending and fraudulent activities that happened at the organization’s three branches namely, Gweru, Bulawayo and Harare. They further elaborated on the prevailing policy thrust of the organisation that stipulated the sector to receive 30% of the total funding.

**Loan Range with the Highest Number of Non-Performing Loans.**

Figure 4.2 show that 81% of the respondents believed US$ (0-500) loan range had the highest
number of non-performing loans, 13% believed above US$5000 and 6% considered the US$(3001-5000) loan range to have obtained the highest number of nonperforming loans.

Figure 4.2 depicted clearly that loans in the range US$(0-500) [81%] obtained the largest number of non-performing loans with those in the range of US$(501-3000) having encountered loans that were all paid.

Those interviewed confirmed that the loan range of US$(0-501) suffered the most number of nonperforming loans and they further sighted absence of monitoring of the projects due mobility challenges of the officers as most of the organisation’s vehicles were reported to have live beyond their lifespan. However previous loan borrowers interviewed seem to attribute this to corruption and fraud that characterize the loan granting decision and lack of follow up on funded.

One loan beneficiary summed this up by saying “You pay the officers, they process your loan fast and they will never follow you up on repayments.”
4.3.2 Sources of Loan Default

In response to the question do following factors contributed to the organization’s bad book, most of the respondents agreed that cost of borrowing, lending over or above the collateral value, lending without sufficient financial and economic analysis, politically motivated or directed lending and integrity of borrower indeed contributed to organization’s bad book. However, the respondents had different views and the results are shown in table 4.4.

Table 4.4: Responses on the sources of loan default

<table>
<thead>
<tr>
<th>Factors</th>
<th>Number</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Unemployment rate</td>
<td>6</td>
<td>22</td>
</tr>
<tr>
<td>Cost of borrowing</td>
<td>23</td>
<td>85</td>
</tr>
<tr>
<td>Lending without sufficient financial and economic analysis</td>
<td>25</td>
<td>93</td>
</tr>
<tr>
<td>Politically motivated/Direct lending</td>
<td>26</td>
<td>96</td>
</tr>
<tr>
<td>Integrity of borrowers</td>
<td>19</td>
<td>70</td>
</tr>
<tr>
<td>Insider loans</td>
<td>4</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: Research data 2014

Table 4.4 depicted all the responses gathered specifically to answer the research question that sought to establish the sources of default on loans advanced by SEDCO. Respondents highlighted that the top four significant factors causing growing bad loan book at SEDCO are politically motivated or direct lending (96%), lending without sufficient financial and economic analysis (93%), cost of borrowing (85%) and integrity of borrower (70%). High unemployment rate (22%) and insider loans (14%) seem to have insignificantly contributed to the organization’s bad book. It was highlighted that the largest exposure in the organization was in the micro
lending with loans in the range (US$0-500).

However, response from interviews reflected short loan tenure, politically motivated lending, corruption on the part of employees and cost of borrowing to have attributed to the bad loan book of the organization. The interview respondents blamed heavily politically motivated lending on the high default rate the organization obtained from group lending and fraudulent activities by employees resulting in the organization failing to recover most of the borrowed funds. The fraudulent activities took place at the following branches; Gweru, Bulawayo and Harare.

4.3.3 CHALLENGES IN SEDCO’S CREDIT RISK MANAGEMENT SYSTEM

Table 4.5 illustrated that 81% of the respondents were not in agreement that the organization recruit highly trained and qualified people in risk management.

<table>
<thead>
<tr>
<th>Agree</th>
<th>No Opinion</th>
<th>Disagree</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>1</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>15%</td>
<td>4%</td>
<td>81%</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Source: Research data 2014*

They all agreed that the organization’s compensation package was quite low to attract individuals possessing high skills in risk management. Hundred percent of the participants also confirmed that the organization has been failing to recruit and retain employees who are highly qualified in risk management due to low total remuneration across the organization’s
employment level. They even said some prospective employees at managerial level failed to take up employment offers with the organization citing poor remuneration.

**Formal and informal training in credit risk management**

Seventy four percent of the respondents agreed that they had never embarked on any course concerning credit risk management as depicted by figure 4.6 below. This is not in agreement with Farrissey (1993) who advocate for community banks to provide training programs in financial statement analysis, credit information exchange, and credit reporting to personnel in lending activities. This was made up of all eight business analysts, seven branch managers and five portfolio controller. Five percent of all the respondents have attended various courses concerning credit risk management. They all understood that credit risk management system is meant to guard against default on non-payment of loans advanced by the organization.

*Table 4.6: Responses on the areas of credit risk management courses covered*

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>20</td>
<td>27</td>
</tr>
</tbody>
</table>

| 26% | 74% | 100% |

*Source: Research data 2014*

Those interviewed further elaborated that staff were being posted to attend various courses in credit risk management to Southern African Development Community Development Finance Institution Resource Centre (SADC DFIRC) for which the organization is member. However, they pointed out that one employee from the organisation attend the training every year on a rotation basis. They also lamented the inflexibility of the courses to address lending conditions obtaining to DFI in Zimbabwe. Hundred percent of the participants concurred that the courses
were mainly suited for the analysis of long term project as opposed to short term loans that characterize the portfolio of the organisation. To date, 2% of the employees have attended the courses with Development Finance Institution Resource Centre.

The Factors Considered When Advancing Loans

Respondents highlighted that the top three significant factors most considered when advancing loans by SEDCO are capital (96%), capacity (81%) and collateral (78%). The rest of the factors seemed to be least considered that is, Character (26%) and conditions (19%).

Table 4.7: Responses on the factors considered in advancing loans

<table>
<thead>
<tr>
<th>Factors</th>
<th>Number</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capacity</td>
<td>22</td>
<td>81</td>
</tr>
<tr>
<td>Character</td>
<td>7</td>
<td>26</td>
</tr>
<tr>
<td>Capital</td>
<td>26</td>
<td>96</td>
</tr>
<tr>
<td>Conditions</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>Collateral</td>
<td>21</td>
<td>78</td>
</tr>
</tbody>
</table>

Source: Research data 2014
Generally, figure 4.3 illustrated that the factors considered when advancing loans by SEDCO where Capital (96%) and Capacity (81%) and Character (26%) and conditions (19%) seem to be least regarded in loan granting decisions. Those interviewed said due to the nature of the funding and structure of the funding the organisation most consider marketability of collateral, character of borrower, asset base of borrower (capital), ability to repay (capacity) and conditions obtained in the economy. A glance at the risk scoring sheet also reviewed that the 5Cs were being used in credit decisions though they appear to be in a different dimension. They consider own contribution (Owner’s equity), estimated residual value of pledged collateral, financial ability,
economic sector, experience of the promoter or directors, key personnel. It can then be safely said the 5Cs are being applied any lending decisions throughout the organisation. This is in agreement with Kabir et al (2010) who pointed out that the 5Cs has to be considered in any lending decision that is, capacity, character, capital, condition and collateral.

Credit Assessment of Prospective Borrower

Table 4.8 depicted that 100% of the respondents agreed that they made use of the credit reference bureau when carrying out credit risk assessment for prospective borrowers. They all agreed that the organisation had subscribed to TransUnion since January 2009 up to date. Those interviewed were in agreement but further highlighted that TransUnion was only able to trace for borrowers who have civil judgments obtained against them but, cannot trace prospective clients who are already indebted to other financial institutions and credit stores. Cases were the organisation was advancing loans to individuals or corporates that are highly indebted to other lenders, who are on black list or have poor credit servicing history were growing and eventually contributed hugely to default on repayments. Most senior loans officers interviewed were fully aware of the absence of a national credit bureau but advised that the Financial Clearing Bureau at the moment was performing a good job in as far as credit clearing is concerned.

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27</td>
<td>0</td>
<td>27</td>
</tr>
<tr>
<td>100%</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research data 2014

Management Information System Report Generation

114
Valid responses for table 4.9 was No. Hundred percent of the respondents believed the current MIS is no capable of producing system generated reminders and monitoring reports. With only 67% also believing that the system is capable of producing reports that serves in risk measurement.

Table 4.9: Responses on System Generated Reports

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Measurement</td>
<td>9</td>
<td>57%</td>
</tr>
<tr>
<td>Monitoring Reports</td>
<td>27</td>
<td>100%</td>
</tr>
<tr>
<td>System generated credit reminders</td>
<td>27</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Source:* Research data 2014

Figure 4.4 below showed that 100% of the respondents agreed that the MIS was not capable of generating both monitoring reports and credit reminders and 67% believed that the current MIS was capable of measuring the risk the organisation was facing. Thus the MIS seem to be inadequate within SEDCO and this is in disagreement with the Bank of Tanzania (2010) which provides that for the MIS to be adequate it must be capable of accurately measure risk, produce monitoring reports and system generated reports.
Figure 4.4: Responses on system reports generation

Senior management concurred and highlighted that they have discarded the old MIS for the new system (Encore Theme) due to the deficiencies the system was having. However, they further hinted that they are still running both the old and new system in parallel to facilitate smooth data migration. They also hinted that a lot of deficiency that where part of the old system still are evident with the current system.

4.3.4 ADEQUACY OF SEDCO’S CREDIT RISK MANAGEMENT SYSTEM

Hundred percent of the respondents knew that the organisation has a credit risk management policy and procedures in place. The existence of the policies and manuals were so confirmed the
researcher as he was shown the documents during the interview process.

Table 4.10: Responses on frequency of manuals review

<table>
<thead>
<tr>
<th></th>
<th>ANNUALLY</th>
<th>BI-ANNUALLY</th>
<th>QUARTERLY</th>
<th>RARELY</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frequency</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>24</td>
<td>27</td>
</tr>
<tr>
<td>Percentage</td>
<td>7%</td>
<td>0%</td>
<td>4%</td>
<td>89%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research data 2014

Seven percent of the respondents believed the policy manuals are reviewed annually, four percent quarterly and eighty nine percent believed they were rarely reviewed. Generally the policy manuals were not being reviewed annually as advocated by the Eastern Caribbean Central Bank (2003) that such documents should be periodically reviewed at least annually to ensure they remain effective.

Source: Research data 2014

Figure 4.6: Responses on the frequency of manuals review

Those who were
interviewed elaborated that the first policy manual for the organisation was first drafted in 2007 and approved for use the same year. Since 2007 to 2012 the same policy manual was being used and they confirmed that it was never reviewed during that period. The one currently in use was drafted in 2012 and was approved by the Board in 2013. Senior management seemed to be unaware of the need for the policy manuals to be periodically reviewed. They even sighted the dearth of the risk department as the main reason why such policy documents were not being periodically reviewed. A scrutiny of the organisation’s credit risk management policies and procedures manual was carried out to assess whether it conforms to the minimum requirements of the documents as prescribed by Eastern Caribbean Central Bank (2009). The results are presented in the form of a checklist, table 4.11 below.

**Table 4.11: Analysis of conformity of SEDCO’s credit policy and procedure manual to best practices**

<table>
<thead>
<tr>
<th></th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is Credit risk philosophy governing the credit risk tolerance of the organisation in place</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>The Composition of approval authority and their approval limits covered</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Targets markets and exposure limits are sufficiently explained</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Facilities offered together with their ceiling, pricing, profitability and maximum maturities are elaborated on the manual</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Criteria and procedures for granting new credits, unsecured credits and for credit restructuring and refinancing clarified</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Grading or rating system is in place</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Types of acceptable collateral and the criteria for accepting guarantees in place</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>
Guidelines for classification, provisioning and write offs in place

Guidelines for related party transactions elaborated

Adapted From: Eastern Caribbean Central Bank (2009). Guidelines on credit risk management for institutions licensed to conduct banking business under the Banking Act, ECCB.

By checking what is contained in the organisation’s credit risk management policy and procedures documents with what is international recommended, it appeared the organisation addressed all the specified issues. But most interviewed participants seem to agree on the on the adequacy of the organisation’s credit risk management system but believed they were heavily lacking on implementation and operationalization. They sighted the exodus of seasoned and experienced senior management and employees due for varied reasons wherein the organisation is now dominated by new employees of no institutional memory, inadequate induction training and refresher training courses. They seem to agree on the need to fully induct new staff and conduct refresher courses on the expectations of the organisation but lamented on inadequate financial resources to embark on such activities.

4.3.5 SUGGESTED IMPROVEMENTS TO SEDCO’S CREDIT RISK MANAGEMENT SYSTEM.

Most respondents advised the organisation to consider extending grace period (96%) and review loan tenure (85%) to at least twelve months as exhibited by table 4.12 below. Those interviewed seemed to be fully aware of the bottle neck the current loan conditions causing on the loan repayments habits of borrowers and highlighted that they have recommended for the review of such conditions to the board and are awaiting for approval. All loan beneficiaries interviewed concurred on the need for the organisation to introduce grace periods depending on the project
nature and they also said the current loan tenure makes the loan unaffordable. They seem to suggest that the organisation review the loan tenure upwards to at least twelve months so that the loan can be spread over a long period, making installments smaller and affordable.

Table 4.12: Responses on grace period and loan tenure

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grace Period</td>
<td>26</td>
<td>96%</td>
</tr>
<tr>
<td>Review Loan Tenure Upwards</td>
<td>23</td>
<td>85%</td>
</tr>
</tbody>
</table>

*Source: Research data 2014*

Minimising Loan Default

Eighty one percent of the respondents agreed that strict monitoring of funded projects could result in minimising default of repayments as shown by figure 4.9 below. Nineteen percent were not in agreement that strict monitoring could minimise default on repayments. Those interviewed sighted lack of strict monitoring of funded projects as the main cause of default by borrowers. They further cited inadequate resources to finance the mobility of officers as the organisation’s bottle neck. They further hinted that it is the organisation’s policy that every project is supposed to be visited at least twice and monitoring reports compiled but the prevailing resources seem not to allow that.
4.4 CHAPTER SUMMARY

This chapter dealt with data presentation and analysis. The chapter presented and analysed the findings from interviews undertaken and questionnaires that were sent out by the researcher. The methodology discussed in chapter three was applied during data collection and analysis and the results shown in textual, tabular and graphical forms. Analysis of respondents’ profiles and key findings were outlined. The chapter unearthed the trend of default, sources of default, challenges and adequacy of SEDCO’s credit risk management system and suggested areas of improvements in the organisation’s loan scheme during the period 2009 to 2012.

The information presented and analysed in this chapter was used to draw some research conclusions and general recommendations in the following chapter. In chapter five the research
results were interpreted and conclusions were drawn. A discussion to determine and justify the acceptance of the research was also carried out. The chapter outlined the benefits and implications of the results, recommendations and suggested areas for further studies.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION
Chapter four looked at the review of the data collected, the methods of analysis and the results of the study. The data and information was presented using tables and graphs and analysed so that the researcher would identify the actual causes of the current research problem. Chapter five, being the final focused on the three main sections which concluded the entire research report. These were summary, research conclusions and recommendations based on the findings.

5.2 SUMMARY
The research study set out to explore the credit risk management peculiar to Development Finance Institutions using a case study of SEDCO for the period covering 2009 to 2012. Loans form a significant part of the asset base of financial institutions. Non-payment of loans impacts negatively on the sustainability and viability of the financial services sector through loss in revenue (interest and principal repayments). Development Finance Institutions have already lost substantial amounts of revenue due to loan default and non-performing loans. However, if the credit risk management system within DFIs is not continuously checked, losses may further increase. As a result of the on-going loan default, SMEs demands for business loans may not be fulfilled. The quantum of revenue lost due to loan default as well as the causes of loan default, challenges and adequacy of credit risk management system have not been established as of yet in the Zimbabwean DFIs. The research sought to ascertain the quantum of loan default, sources of
default thereof, ascertain challenges in the organisation’s credit risk management system and its sufficiency and finally provide recommendation on how the credit system could be enhanced to minimise default.

In this study, the researcher obtained most of the literature reviewed from the internet, journals and textbooks. The researcher used both quantitative and qualitative research methods in a complementary fashion when collecting data on the credit risk management in DFIs. The triangulation enabled the findings of the study to withstand criticism. The specific qualitative techniques that were used in the collection of data were face to face interview and desktop research whilst the self-administered questionnaire was used as a quantitative research technique. The researcher had to make use of spread excel, graphs, tables and descriptive narrations to present and analyse collected data and information. The population of the study had 580 people that comprised of SEDCO management (senior, middle and line), employees, loan beneficiaries and senior loans Officers from local banks. Six senior and middle managers, sixteen branch managers and business analyst, eight portfolio controllers, ten senior loans officers from three local banks and ten loan beneficiaries were selected to constitute a sample of fifty-six participants that fairly represented the population.

5.3 CONCLUSIONS

The analysis made it possible for the researcher to draw relevant conclusions of the study. The following were the conclusions drawn from the research:
5.3.1 TO ASCERTAIN THE LEVEL OF LOAN DEFAULT WITHIN SEDCO SINCE 2009.
Findings from the study indicated that there was an upward trend in loan default since 2009. The upward trend was attributed to the growth in the loan book of the organisation during the period of the study mainly within the microfinance unit. The loans were unsecured and this ended up frustrating recovery efforts as cost of litigation outweighed the amount to be recovered.

5.3.2 TO ESTABLISH SOURCES OF DEFAULT ON LOANS ADVANCED BY SEDCO.
It emerged from the research findings that cost of borrowing, politically motivated lending, integrity of borrowers, lending without sufficient financial and economic analysis and fraudulent activities on the part of employees were the main factors that caused default on loan repayments. Insider loans and high unemployment seemed to have limited influence on the default on the loan advanced by the organisation.

5.3.3 TO ASCERTAIN THE CHALLENGES INHERENT IN SEDCO’S CREDIT RISK MANAGEMENT SYSTEM.
It was found that the organisation suffered from a myriad of challenges that includes in ability to recruit and retain personnel with extensive background in risk management, inappropriate and inadequate training modules in risk management peculiar to the organisation’s lending activities, overlooking of economic conditions and character of borrower when making lending decisions. TransUnion seemed to be failing to adequately assess indebtedness of the organisation’s prospective borrowers and the MIS seemed to be unable to measure risks faced by the organisation, produce monitoring reports and credit reminders.

5.3.4 TO ASCERTAIN THE ADEQUACY OF SEDCO’S CREDIT RISK MANAGEMENT
SYSTEM

Research finding indicated that overall the organisation’s credit risk management system is adequate as but lacked on operationalization and implementation. The policy documents seemed to sufficiently cover most of the internationally recommended issues the credit risk management policies and procedures are expected to spell out.

5.4 RECOMMENDATIONS

Based on the above conclusions, the following recommendations are proposed.

5.4.1 INTENSIFY PROJECT MONITORING / CREDIT RELATIONSHIP MANAGEMENT

Project monitoring efforts should be intensified. The organisation should ensure that officers perform periodic follow ups on borrowers to ensure that loans are used for the intended purpose and adequate resources should be availed for such activities. This will ensure fund diversion and project challenges are identified before they become perennial. Project monitoring on its own is a powerful collection of tools that can serve to ensure that borrowers pay their instalments as they fall due.

5.4.2 CREDIT EVALUATION / CREDIT WORTHINESS ASSESSMENT

The organisation should shift from TransUnion to Financial clearing Bureau (FCB) and thoroughly investigate the past credit worthiness records of loans applicants. FCB if adequately utilised is likely to trace on prospective borrowers’ dealing with any financial institutions within the country. Applicants on blacklist and adverse judgements will be identified and proper lending decisions made thereon which are likely to reduce incidence where applicants with adverse judgments and already over indebted are extended loans. This will serve to minimise loan default
as most applicants of good financial standing and with little financial commitment are likely to be advanced loans.

5.4.3 TRAINING AND DEVELOPMENT

Since the organisation is a fully subscribed member of the SADC DFIRC, it must lobby for the introduction of training modules peculiar to its lending activities and an increase in the quota of its employees that will attend the SADC DFIRC initiated courses. The organisation could also approach financial institutions like CBZ, Stanbic, Ecobank and AGRIBANK to arrange for its employees in the lending and risk functions to go on exchange programmes. This could involve the organisation’s employees being posted to these financial institutions to understudy their credit process or cycles with a view to understand what makes their default rate not worrisome and implement learned ways in managing credit process back at the organisation. The business models at such financial institutions could be at least replicated at SEDCO in an attempt to arrest the current worrying default level.

5.4.4 OPENING OF FRAUD OR CORRUPTION TIP OFF PLATFORMS

The organisation should moot a move to open up anonymous 24-hour toll free telephone and cellphone lines for members of the public to report any cases or tips of fraud or corruption by employees of the organisation. The platform must be administered by the organisation’s external auditors in conjunction with the Loss control department and the board must sufficiently empower them. Independent thorough investigation must follow and if found to guilty appropriate disciplinary action must be pursued. Once fraud and corruption activities are stamped out, the organisation stands to have default levels reduced.
5.4.5 INTERNAL REWARD AND COMPENSATION SYSTEM

Employees should be fairly remunerated based on prevailing market rates obtained within the financial services sector so as to retain experienced personnel in lending activities. This can also minimise insurgent of unethical behaviour as most such behaviour are normally are result of meagre remuneration. Once employees are fairly paid chances are high that their work will be done in a professional and integrity manner, wherein policies and procedures would be religiously followed and enforced in such a manner that money advanced could be traceable.

The reward system should be structured in such a manner that any unethical behaviour observed and proved against employees such as fraud and corrupt in any lending activity should result in instant dismissal and those employees who exhibit good behaviour should be rewarded positively. This could result in employees striving to observe professionalism and integrity in the discharge of their duties which could eventually reduce cases of corruption and fraudulent activities and finally will reduce levels of non-performing loans.

5.4.6 UPGRADE OF MIS

There is need to approach the software developer of the current MIS that is, Encore Theme, to have the system upgraded to be compatible to measure risks faced by the organisation, produce monitoring reports and credit reminders. Once the MIS is capable of generating these reports it becomes easily to monitor individual loan account, the whole portfolio, be in constant touch with borrower which is a very strong collection tool from accounts in arrears. The can even make sectorial performance analysis easier and this can also service the different management levels of
the organisation with relevant information for various decision making.

**5.4.7 ENFORCEMENT OF THE CREDIT RISK MANAGEMENT POLICIES AND PROCEDURES**

The organisation should consider operationalization of the credit policies and procedures. This could be done through inviting various employees within the lending and risk units for participation during drafting of the manuals and open for continuous feedback from them. This will assist in their buying in. Once the draft is approved, an awareness workshop has to be organised where employees should be educated on the need to refer to the manual during all the credit processes and the consequences of not following it. Implementing champions should be delegated to line managers with the middle and senior management providing oversight role. All employees within the lending units should then be provided with the policy and manual documents and acknowledge receipt of the documents and any new employees joining the organisation must be provided with the same, fully oriented and sign for them.

**5.4.8 LOAN SCHEME**

The micro finance or unsecured lending scheme should be temporarily closed whilst modalities to have borrowers use their moveable assets as collateral are being water tighten to enhance recovery of outstanding loans in case of default. The application and service fees need to be revised downwards as part of the loan is committed before one gets the loan disbursed. There is also need to consider extension of grace period depending on the nature of the project. The loan tenure needs also be reviewed to at least twelve months so that the instalments are spread over a longer period. This will make the loan affordable and resultanty reduce cases of default.
5.5 **FUTURE AREAS OF RESEARCH**

The researcher recommends further research on the following topics.

- The impact of corporate governance on the management of bank risks in developing countries: A case study of all DFIs in Zimbabwe.

- An assessment of the impact of effective credit management on DFIs’ survival in developing world: a Case study of all DFIs in Zimbabwe.

- An evaluation of credit risk management practices in Micro Finance institutions (MFIs): A case study of all MFIs in Mashonaland Central.

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The Newsday, (7 May) 2013.

The Herald, (7 May) 2013

The Sunday Mail, (4-10 August) 2013.


Appendix 1: Letter of Introduction for Face to Face Interview

House No 1762
Chiwaridzo
Bindura

17 January 2014

Dear Respondent

Re: REQUEST THAT WE MEET FOR A FACE TO FACE INTERVIEW.

Dzinavatonga Jimmy is my name, a student at Bindura University, registration number B1027857. I am currently studying for a Masters in Business Leadership Degree and research is a compulsory component of MBL programme.

I have carefully selected you to assist me by having a face to face interview with you. The interview is to be private that is communication and whatever we are going to discuss will be only our concern, hence feel very free to disclose as much information as you may.

All information disclosed to me will be used for no other purpose other than for the purposes of my academic research studies. The information so discussed will be kept confidentially at all times.

I thank you dearly for the assistance that I believe you will accord me unconditionally.

Yours Faithfully

Jimmy Dzinavatonga
Email Address: jdzinavatonga@yahoo.com
Cell Number: 0773492390 or 0736957093

Appendix 2: Research Questionnaire

Dear Respondent, My name is Jimmy Dzinavatonga. I am currently carrying out a study for the
purpose of writing a dissertation as a requirement for the award of Master of Business Leadership of Bindura University of Science Education. The topic of study is CREDIT RISK MANAGEMENT IN DEVELOPMENT FINANCE INSTITUTIONS: THE CASE STUDY OF SMALL ENTERPRISES DEVELOPMENT CORPORATION (2009-2012). You have been selected to participate in this study due to the importance of your information in the study. The information you provide will only be used for the purpose of this study and will be treated with utmost confidentiality. You may kindly contact me on 0773492390 or at jdzinavatonga@yahoo.com (e-mail address) should you need any verbal clarification or for any other comments.

Please feel free and answer all the questions truthfully.

*Please indicate your response by a tick in the appropriate box*

**SECTION A.**

RESPONDENT’S BACKGROUND

1. What position do you currently hold in the organization?  
   - Branch Manager  
   - Business Analyst  
   - Portfolio Controller  
   - Other (Specify)……………

2. What is your highest level of education?  
   - Certificate/Diploma  
   - Bachelors  
   - Masters  
   - Other Specify):………………..  

3. For how long have you served in the organization?  
   - 1-3 years  
   - 4-6 years  
   - 7-10 years  
   - 10+ years  

**SECTION B: RSEARCH QUESTIONS**

4. Indicate nature of credit your organization offer?  
   - Short term (payable within 1-2 years)  
   - Medium term (payable within 5-10 years)  
   - Long term (payable over 10 years)  

5. Is there a grace period?  
   - Yes  
   - No  

6. If yes to Question 2, how many months?  
   - 0-1 months  
   - 2-3 months  
   - Above 4 months  

7. Indicate the number of loans advanced under each amount range between 2009 and 2012.  
   - US$[0-500]  
   - US$[501-3000]  
   - US$[3001-5000]  
   - Above US$5000  

8. Refer to Question 4, Which loan range had the highest number of non-performing loans?…………………………………………………………

9. Suggest improvements to the loan scheme:…………………………………………………………………………

10. The following factors seem contribute to have the organization’s bad book (mark X at the appropriate place in one of the two columns).

<table>
<thead>
<tr>
<th>Factors</th>
<th>Yes</th>
<th>NO</th>
</tr>
</thead>
</table>
High Unemployment rate
Cost of borrowing
Lending over / above the collateral value
Lending without sufficient financial and economic analysis
Politically motivated or directed lending
Integrity of borrower
Insider loans
Others (Specify):…………………………………………………………………………

11. Suggest ways to minimise default:...................................................................................

12. The organization recruit highly trained and qualified people in risk management.
   Agree ☐ No opinion ☐ Disagree ☐

13. Which areas in credit risk management did you cover?..........................................................

14. The organization encourages formal training in risk management.
   Yes ☐ No ☐

15. List factors you consider when advancing loans:.................................................................

16. Do you think SEDCO is adequately assessing credit applications?
   Yes ☐ No ☐

17. Does your organization make use of the credit reference bureau for credit risk assessment?
   Yes ☐ No ☐

18. If No to Question 14, how do you get to know of the repayment habits and current debt of potential borrowers?
   Please provide and explain your sources:............................................................................

19. Have you ever met incidences where you advance loans to a borrower already heavily indebted to other organizations?
   Yes ☐ No ☐

20. If yes to Question 16, was the loan paid off well?
   Yes ☐ No ☐

21. Does the management information system for your organization cover the following areas?

<table>
<thead>
<tr>
<th>Area</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk measurement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Produce monitoring reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Produce system generated credit reminders</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

22. Comment on the adequacy of the Management Information System with respect to the nature of your organization’s activities:.................................................................

23. Does the organization have a credit and risk management policy and procedures manual?
   Yes ☐ No ☐

24. If yes to Question 20, how often are the manuals reviewed?
   Annually ☐ Bi annually ☐ Quarterly ☐ Other (Specify):.........................

25. Does the organization’s credit risk management policy, procedures and limits adequately provide for the identification, measurement, monitoring and control of risks faced by its lending activities?
   Yes ☐ No ☐

26. Comment on the organization’s overall credit risk management system:............................

27. Please read the questions carefully and mark (X) in the appropriate box in one of the three
<table>
<thead>
<tr>
<th>Question</th>
<th>Agree</th>
<th>No Opinion</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is a common understanding of risk management across the Institution</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Responsibility of risk management is clearly set out and well understood across the institution</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The institution’s reporting and communication processes support the effective management of risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The institution’s risk management processes are well documented and provide guidance to staff about the management of risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The institution’s finds it difficult to identify and prioritize its main risks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The institution finds it difficult to manage credit risk?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The institution’s level of risk control is appropriate for the credit risk that it faces</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

28. What do you consider to be the strengths of SEDCO loans?

29. What do you consider to be the weaknesses of SEDCO loans?

30. Any other comments:

Thank you for your assistance in answering this questionnaire.

Appendix 3: Interview Guide

Interview Number:………………………………………………

Date:…………………………………………………………

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1. Which sectors of the economy or types of projects does your organization finance?
2. What are the factors SEDCO consider when approving loans?
3. What is the level of loan default within SEDCO since 2009?
4. What factors could be attributed to loan default within SEDCO?
5. What are the challenges inherent in SEDCO’s credit risk management system?
6. How would you rate the risk management framework of SEDCO?
7. To what extent do you agree that there are intervention strategies within SEDCO to improve on credit risk management system in order to minimise default?
8. What do you think should be done in order to minimise default rate?

Thank you for your assistance.