# MANAGEMENT OF CREDIT RISK; THE CASE OF SOUTH AKIM RURAL BANK LIMITED, KOFORIDUA

by



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## DECLARATION

I hereby declare that this submission is my own work towards the Commonwealth Executive Master of Business Administration (CEMBA) and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.



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## DEDICATION

I humbly dedicate this work to my sister Dorothy Danquah and the husband Mr. S. Y. Larbi who gave me their support and other resources to accomplish this research work successfully. Also to my wife Mrs. Sarah Odame Lartey and my Children for having patience and encouragement during my absence at home most often. May the good Lord bless them all for whatever they have invested in this research work.

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# ABSTRACT

The research was on an examination of the management of credit risk at the South Akim Rural Bank in Koforidua. Descriptive survey was used and the purposive and the systematic methods of sampling were used to select the study units. A questionnaire was used for the employees while the Branch Manager, and the other staff purposively selected were interviewed in addition to responding to questionnaires. The study revealed that most customers were familiar with the processes for granting loans and they mentioned some of these; the qualification requirements for loans are only sometimes made known to potential loan applicants; most customers have taken loans from the bank but when it comes to the repayment of such loans, most of them default mainly as a result of failures of the businesses they invest in. The study revealed that the most often used measure of credit risk reduction is through the use of collateral security, guarantees and stringent management practices. The study concluded that the management of credit risk is a big issue at the South Akim Rural Bank in Koforidua and though there were some measures in place at the bank for the reduction of the risks associated with credit, such measures did not seem to be very effective.

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# CHAPTER ONE

# INTRODUCTION

## 1.1 Background to the study

The financial system of Ghana is made up of a number of banks and non-bank financial institutions. At the helm is the Bank of Ghana which has the responsibility to advice central government on financial matters. Rural banks are a part of the financial system and have been established as unit banks to provide financial intermediation and other services of financial orientation in the rural communities where they are located. According to Miller and Van House (1993), rural banks were introduced into the country to overcome the poor savings habit of most rural folks in order to turn around this problem, and boost their savings habit of rural dwellers and to make loans accessible to them to support their economic activities. Rural banks are thus financial institutions established among others, to provide banking services to small businesses as well as rural entrepreneurs.

A major rural bank that is involved in the provision of credit facilities to the rural folk is the South Akim Rural Bank Limited The bank was established on 25th August,1984 and was commissioned on 2nd November, 1984 with a staff strength of five (5). By the end of December 2010, the staff strength had increased to one hundred and five (105). Subsequent recruitments have since been made.

The key promoters of the bank were the late Major (Rtd) Samuel Boadi Gyasi, one time Managing Director of the Produce Buying Company (PBC). He together with the lChief of Nankese Nana Ayim Gyasi II, Nana Adarkwa Yiadom Odikro of Nankese, Mr. Godfred Daniel Asante, all deceased, and Mr. Benjamin Atta Koranteng promoted the bank. Some of the initial directors were Mr. M. N. A. Afrifa-Gyasi, the late Chief Farmer of Nankese Nana Kwabena Donkor Yirenkyi, Mr. F. N. Gyasi (deceased), Mr. A. B. Asante, Mr. George Diabene Agyakwa and Mr. Adams Henaku. These people, together with several other shareholders, helped to establish the bank.

The head office of the bank is located at Nankese which is a town in the Suhum Kraboa-Coaltar District. In September, 1987 the bank extended its operations to Suhum and later opened other agencies in Koforidua on 8th October, 1993 and Asamankese on 3rd February, 1995. The Adoagyiri Agency was commissioned on 6th November, 2006 while the Osenase Agency was also officially opened on 26th August, 2010. Full-scale banking services are provided at all these agencies and continuing efforts are being made to computerise and network all the agencies.

The bank's vision is "to be among the leading banks in the country" and its mission is to become the leading rural bank and market mover in the Eastern Region, as well as to be ranked among the best five (5) rural banks in Ghana. Among the pronounced corporate values of the bank are efficiency through team work, customer satisfaction, profit maximisation and community development.

The bank provides services to a large number of salaried workers who are paid by the Controller and Accountant General and other employers as well as to educational institutions, religious bodies, social organisations and district assemblies. The bank also provides services to other people in its catchment areas who are mostly engaged in farming specifically in cocoa, food crops and vegetable farming as well as in rural industries such as distilling of liquor, charcoal production, basket weaving, transportation, logging and timber production and also stone quarrying.

The bank gives commercial loans, agricultural loans, salary advance and workers' loans. In addition the bank operates a 'golden account' which is a special account for a variety of customers both individuals and companies whose desire is to operate a current account and earn interest which otherwise would not have been possible. To join the scheme, the individual must be a person who earns monthly or periodic income. There are many benefits from joining the scheme; it serves as an **investment account for the current account customer, it helps the customer to build a handsome balance that paves the way for that customer to secure a loan from the bank and it also makes it possible for the customer to be placed in the bank's valued customers' bracket.**

Since its inception, the South Akim Rural Bank has been very influential in poverty reduction, the creation of employment and income opportunities through support for the setting up of micro enterprises, empowering women and/or other disadvantaged groups as well as reducing the rural families' dependence on drought prone crops through the diversification of income generating activities.

## 1.2 Problem statement

As indicated in the background of the study, the South Akim Rural Bank has operated successfully since its incorporation through the provision of excellent banking services to its numerous customers. However, according to Kohn (1993), a number of common problems appear to inhibit the operations of rural banks and these include the cost of mobilising savings from the widely dispersed rural dwellers most of whom live below the poverty line, absence of the required collateral security to support commercial lending, difficulty in loan recovery, problems of determining the interest rate on loans to cover cost and at the same time make the loans attractive to customers, inappropriate credit management policies and inadequate information to potential bank service users.

The South Akim Rural Bank in Koforidua, which is the focus of this investigation, appears to have its fair share of the problems highlighted above. The researcher therefore seeks to examine the above issues at the bank in Koforidua in order to ascertain how the nature of the credit management practices influence the overall operations of the bank.

## 1.3 Research objectives

The main objective of the study was to examine the nature of credit risk at the South Akim Rural Bank in Koforidua and how the bank's credit risk management policies and procedures influence the overall operations of the bank. Specifically, the study sought to:

1. Assess the qualification standards of customers for loans at the South Akim Rural Bank in Koforidua;

2. Examine the bank's processes for granting loans;

3. Identify the problems encountered in loan recovery from the bank's customers; and

4. Examine measures in place to enhance loan recovery and credit risk reduction at the bank.



## 1.4 Research questions

The study addressed the following questions:

1. What qualify customers for loans at the South Akim Rural Bank?
2. What processes are used in granting loans to customers?
3. What problems are encountered by the bank in its attempt to recover loans from customers?
4. What are the measures used by the bank to enhance loan recovery and reduce credit risk?



## 1.5 Relevance of the study

A study on credit risk management will contribute to existing knowledge and literature on the subject under investigation. In that regard, it is hoped that the study will provide data related to problems associated with credit risk management at the South Akim Rural Bank in Koforidua so that remedial action, especially in the area of providing information for enhancing policies and procedures on credit risk management at the bank, could be taken by the management of the bank.

## 1.6 Scope/limitations of the study



Koforidua was the study area and the focus of the study was on the South Akim Rural Bank in order to examine in some detail, the credit risk management activities at the bank. Though the research could have been extended to cover some other rural banks as a way of getting a broader coverage and extended findings, time and financial constraints made this a problem.

## 1.7 Organisation of the thesis

The study consists of five chapters. The first chapter focuses on the background of the study, problem statement, research objectives, research questions, relevance of the study, scope/limitations of the study and the organisation of the thesis. Chapter two contains a review of literature relevant to the study. The literature covered the definitions of concepts, principles and other necessary information on understanding credit risk management from various textbooks, management reports and other secondary data sources. The methodology used in this study is also set out in chapter three. It discusses the research design, population, sample and sampling procedures/techniques, data collection tools/procedures, and the data analysis/presentation procedures. Chapter four entails the presentation of results and its discussion. Chapter five is made up of the summary of findings, conclusions arrived at and the recommendations made.



# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter presents a review of literature covering topics like the definitions of credit, forms and importance of credit, risks associated with the provision of credit or lending, credit risk management, general procedures involved in lending, loan policy, credit analysis appraisal, loan review and evaluation, the regulatory framework of rural banks, registration of rural banks, supervision, the credit function of rural banks, lending procedures in rural banks and the credit life time. These will be examined and discussed from textbooks and other publications on the topic.

## 2.2 Definitions of credit

Credit has been given varied definitions by different authors. The International Dictionary of Management (2003) refers to it as borrowing up to a certain limit by a bank to an individual or a company. According to Wood (1988), credit is derived from a Latin word ‘credere’ which means ‘believe’. From this, he defines credit as an expression of belief in a person’s ability and willingness to repay a loan.

Miller and Van Horne (1988) considered credit from two dimensions. Firstly, they see it as an asset and secondly as a liability. To them, credit represents a future receipt to the lender and a future obligation to the borrower. They therefore define it as a transfer of title to real goods and services.

Maller, et al (1998) consider credit to mean transactions in which goods are sold, services are rendered or money is given out in exchange for a promise to pay back at some future date. James et al. (2002), define credit as a liability acquired when we borrow funds.

From the above definitions credit can be defined as making or offering some advances under specific repayment terms by a bank to its customers under the belief that such loans shall be repaid as agreed.

### 2.3 Forms and importance of credit

The Bank of Ghana’s Credit Manual for rural banks stipulates that, credit facilities may be granted for the purpose of conducting or carrying on developing or improving farms, fishing, industrial and commercial operations to benefit the community (BOG Manual, 2009). According to the manual, credit facilities may also be extended to maintain the efficiency of eligible borrowers in connection with their health, education and sustenance.

Writing on the importance of the lending functions, Crosse and Hempel (1998) argue that traditionally, the foremost obligation of a bank is to supply the credit needs of business enterprises including farm operations.

Affirming this stance, Rose and Kora (1999) touch on the significant quatitative contribution of lending to rural banks' income as well as the important role this plays in the social functions that the banks perform in the economy.

For a full realisation of the above benefits, rural banks give loans and overdrafts. According to Rose and Kora (1999), an overdraft is the amount a customer is allowed to withdraw over and above his or her normal deposit with the bank. Interest is charged only on the excess amount over the deposit. Overdrafts are normally granted to current account holders.

Valentine and McCarthy (2001) observe that discounting bills is a third form of credit. When a holder of a bill wants money from his bank, the money the holder of the bill collects is less than the face value of the bill. The difference is a fee charged by the bank called a discounting charge for performing such services.

## 2.4 Risks associated with lending

Like all other investments, lending cannot pass without some level of risk. Risk is defined as any event that can lead to a credit made available to a customer of a bank being lost or leaving the repayment impaired (Harington, 2003).

According to Brealey et al. (2006), finance companies, like other financial institutions, are exposed to three types of risks. These are liquidity risk, interest rate risk and credit risk. Brealey et al. explain the risks as follows:

1. **Liquidity risk –** Finance companies generally do not hold accounts that could be easily sold in the secondary market. Thus, if they are in need of funds, they have to borrow. However, their balance sheet structure does not call for much liquidity. Virtually, all of their funds are from borrowing rather than deposits. Consequently, they are not susceptible to unexpected deposit withdrawals. Overall, the liquidity risk of finance companies is less than that of other financial institutions.

2. **Interest rate risk –** Both liabilities and assets maturity of finance companies are short-term. Therefore, they are not as susceptible to increasing interest rates. Finance companies can still be adversely affected, however, because their assets are typically not as rate sensitive as their liabilities they can shorten their average asset life or make greater use of adjustable rate if they wish to reduce their interest rate risk.

3. **Credit risk –** Because the majority of finance company funds are allocated as loans, customers who borrow from such companies usually exhibit a moderate degree of risk. The loan delinquency rate of finance companies is typically higher than that of other lending financial institutions. However, this higher

default level may be more than offset by the higher average rate charged on loans. Again, because their loan entails both relatively high returns and high risk, the performance of finance companies can be quite sensitive to prevailing economic conditions.

Harington (2003) posits that there is credit risk where a firm's customers and the parties to which it has lent money to will delay or fail to make promised payments. Most firms face some credit risk for accounts receivable. The exposure to credit risk is particularly large for financial institutions such as commercial banks that routinely give out loans that are subject to risk of default by borrowers. When firms borrow money, they expose lenders to credit risk (i.e. the risk that the firm will default on its promised payments). As a consequence, borrowing exposes the firm's owners to the risk that the firm will be unable to pay its debts and thus be forced into bankruptcy and the firm generally will have to pay more to borrow money as credit risk increases. The extent of risk of default in the rural sector has deterred most banks from supporting that sector.

In financial markets, banks earn profit to sustain their operations by means of lending to borrowers. However, such banks have to deal with some amount of risk because information on borrowers raises uncertainty and introduces information asymmetry. To ensure that credit will be repaid and for that matter reduce the problems associated with information asymmetry, banks enter into contractual agreements with borrowers. For financial institutions to function effectively, staff, depositors and borrowers need to be provided with relevant and reliable information on timely basis.

Moreover, Padman (1988) notes that small rural producers especially are reluctant to approach formal financial institutions for assistance for a number of reasons. There is a perceptible cultural gap between formal lenders, mostly originating in the urban environment and the rural borrowers who are accustomed to a different way of borrowing money. More importantly, information relating to various credit schemes and their associated formalities and obligation do not reach small producers particularly when they are illiterate. Since formal education has always contributed to moulding, shaping and fashioning out culture, for the illiterate folk assessing credit in formal institutions, the situation is not a difficult one but it is one issue where diametrically opposed cultural values collide explaining the phenomenon of a cultural lag rooted in a traditional set up that is moving towards modernity.

According to Winter, Nelson and Anna (2002), credit rationing, access to credit and liquidity constraints are related but distinct issues for rural finance. Stieglitz and Weiss (2004) opine that because of transaction costs and asymmetric information, lenders are generally unwilling to distribute credit based on price alone. Credit markets are therefore subject to credit rationing, in which suppliers lend less than they could at the prevailing interest rates and allocate credit based on some non-price consideration. Under credit rationing, a potential borrower may be unable to borrow a desired amount even if she/he is willing to pay the prevailing interest rate. A firm or household has a liquidity constraint when it lacks the finance from any source to undertake an investment that is profitable at the prevailing input factor and output prices. A liquidity constrained agent may have access to some credit but not be able to borrow as much as optimally under the given terms and price, or may face terms that are inconsistent in timing with the investment. Thus, households with access to credit may or may not be liquidity-constrained. The same is true for households with no access to credit at all. An agent with no access to credit who also has no investment needing finance is not liquidity constrained but an agent with an investment opportunity and no access to finance may be. Finally, a household that is not liquidity constrained at the prevailing price is likely to wish to borrow at a subsidised rate. Demand for participation in a low-cost credit programme does not necessarily imply that a liquidity constraint was previously binding. Reduced cost of credit with increased access will relax a liquidity constraint. Improved financial services that facilitate savings, direct income transfer and reduced cost for consumption of goods could each alleviate a liquidity constraint without influencing access to credit or the cost of borrowing.

## 2.5 Credit risk management

Hetel (1994) contends that any attempt to define management is deemed to fail mainly because it is diverse and continually changes. Stoner and Freeman (1995) define management as the process of planning, organising, leading and controlling the work of organisational members and using all available organisational resources to reach stated goals.

Financing involves risks which have to be managed by the bank. The management of risk involves determining what risks exist in an investment and handling these risks in a way best suited to the financing or investment objectives (Mwime, 1995). The management of credit must be guided by regulation in order that a bank will be protected in its management of the various risk factors involved in the granting of an advance. The legal requirements for credit risk management do not only operate at the time of financing the loan but also must be given a consideration and properly effected even before an applicant becomes a customer to the bank.

According to Stellenson (2007), Risk is inherent in projects. They relate to the occurrence of events and can leave undesirable consequences, such as delays, increased cost and inability to meet technical specification. In some instances, there is the risk that an event will occur that will cause a project to be terminated. Although careful planning can reduce risk, no amount of planning can eliminate chance events due to unforeseen or uncontrollable circumstances. Stellenson further suggests that the probability of the occurrence of a risk event is highest near the beginning of a project and highest near the end. He therefore stated that good credit risk management curtails the following:

1. Identifying the risk;
2. Analysing and assessing those risks;
3. Working to minimise the probability of their occurrence; and

4. Frequently monitoring critical project dimensions with the goal of catching and eliminating problems in their early stages, before they cause extensive damages.

It is expected that, the increased level of monitoring with newly introduced daily report, intensified weekly reviews and sanctioning of delinquent staff will promote measures which should improve the quality of portfolio growth. (Business and Financial Times, 2008).

To sum up, credit risk management could be seen as a systematic planning and organising of all available bank resources in order to grant credit in a highly professional manner by directing such credit to various sections of the economy, so that profitability and the economy's ultimate security of the bank's assets are not sacrificed.

## 2.6 Procedures involved in lending

Fraser and Korari (1989) maintain that failure is normally the result of reckless lending, lack of diversification or both. Hempel, Simonson and Coleman (1994) support this view but add that effective organisation and control of the lending function are vital to the profitability and solution to every bank. Rose and Conrail (1995) recommend the formulation and implementation of sound handling policies and so considered these to be among the most important responsibilities of bank directors and management. They intimate that before establishing a loan policy, the institution needs to be concerned about how individual applications are evaluated.

## 2.7 Loan policy

Rose and Korari (1995) outline the following components that should be a part of a loan's policy:

1. **Objectives:** This involves the development and a re-examination of the loan to provide Directors with the opportunity to evaluate the role of the bank in the community's economic development.
2. **Trade Areas:** Both primary and secondary areas should be designed to instruct loan officers of the bank on geographic priorities. According to Crosse and Hampel (1980), the bank should define the areas to service routinely by each bank officer.
3. **Loan Mix:** The mix of credit that the bank is to emphasise on and what might be the appropriate balance of each type of loan in the portfolio needs to be specified. Such specification should be made with regards to the demand of the local economy as well as the size of the bank and expertise of its management (Rose and Korari 1995).
4. **Loan Pricing:** An important issue concerning how to adjust the rate charged as perceived risk of the loan varies, one possibility is to group the loan into risk category (Rose and Korari 1995).
5. **Credit Standard:** Loan policy should indicate both desirable and undesirable types of collateral. It should further indicate circumstances in which unsecured lending is prohibited. The quality and liquidity of collateral must be verified and

maximum loan collateral value ration should be applied before a secured loan is approved. (Hempel, Simonson and Coleman 1994).

6. **Loan Authorisation and approval:** The policy should establish lending for all loan officers and for a combination of officers and loan committees (Hempel, Simonson and Coleman 1994).

## 2.8 Credit analysis appraisal

According to Maness (1998), credit analysis is the process of deciding whether or not to extend credit to a given customer. The mission of the credit manager is to set out the terms for credit, grant credit to customers, monitor payment made by customers and apply the necessary measures to maintain or reduce the average collection period. The second activity of the credit manager is the granting of credit. Maness outlines certain individual traits that must be used for such analysis namely the five C's that is character, capacity, collateral, capital and condition of the customer to support the granting of good loan, easy recovery as well as minimising the risk associated with lending.

Wethersfield (1996) opines that in granting credit, a firm determines how much effort to expend trying to distinguish between customers who will pay and customers who will not pay.

## 2.9 Loan review and evaluation

Hempel, Simonson and Coleman (1994) suggest that every loan policy should require diligence on the part of loan officers. They identify certain indicators to aid loan officers in the detection of problems associated with loans. These include insufficient deposit balance and the occurrence of overdraft, late payments of principal and interest and delays in the submission of periodic financial statements.

According to Wethersfield (1996), there are no magical formulas for assessing credit risk and the probability that a customer will not pay a loan. Wethersfield also suggests that the classic five (5) C's of credit are the basic factors to be evaluated and he discusses these factors as follows:

1. **Capacity:** The customer's ability to meet obligations out of operating cash flows.
2. **Capital:** The customer's financial reserves.
3. **Collateral**: Assets pledged by the customer for security in case of default.
4. **Character:** The customer's willingness to meet credit obligation.
5. **Condition:** General economic conditions with customer's line of business.

According to Kerr (2002), firms may be given line credit. This allows such firms to finance temporally cash needs. Line credit is usually established on year-to-year basis between a bank and its customers. The line credit is an agreement whereby the bank sets out a maximum amount it allows the firm to owe at anytime depending on an assessment of the firm's credit worthiness. Kerr (2002) adds that credit provision involves the exchange of money or money's worth for a promise to repay in future. This is not straight forward because borrowers know more than lenders about their debt settlement prospects. For lenders, the challenge is to access the value of that promise to repay. This involves two distinct but equally important steps. First is the collection of information about the person covering proof of identity, age and proof of income, current commitment and other relevant details for the assessment of ability to repay the loan. This information is collected and held by the lender. Some of the information is required for loan assessment purposes, some for what Akerlof et al. (2001) referred to as privacy forum and other statutory purposes related to lending.

Akerlof et al. (2001) further state that there is the need to check the credit history of the applicants to see what record they have of managing credit responsibility in the past. Kerr (2002) also mention that a person is deemed creditworthy when confidence is established about his ability and willingness to honour a promise to repay. Credit reporting is one of the few examples of co-operation between lenders. The fact that lenders are in competition with one another limit the information they share. The information provided by credit reporters must be relevant to lenders information and its value must be dependent on its reliability.

## 2.10 The regulatory framework of rural banks

Various statutes, regulations and the common law control the formal and functioning of rural banks.These include the following:

1. Companies Code of 1963, Act 179.
2. Banking Act of 1970, Act 339.
3. The banking Regulatory of 1973.

## 2.11 Registration of rural banks

With the completion of the acquisition of capital, business premises and drafting of the regulation, rural banks are to register in accordance with section 14 of the company's code. Upon registration, the registrar will issue a certificate of incorporation with its inclusive evidence that all the requirements of the code in respect of registration have been complied with and that the rural bank has been duly registered under the code.

After the incorporation, the promoters of the bank apply for a banking license from the Bank of Ghana in fulfillment of the requirements under Section 2(1) of the Banking Act of 1970 (Act 339). Rural banks are required under Section 27 of the Ghana Companies Code of 1963 (Act 179) to obtain a certificate to commence business from the register general office. This certificate empowers rural banks to start operations.

## 2.12 Supervision

In the course of business, rural banks are subjected to the Bank of Ghana's supervision. The Ghana Companies Code 1963 (Act 179) and the Banking Act of 1970 (Act 339) empower the Bank of Ghana to supervise the activities of the rural banks in the form of demanding periodic submission of returns to the Registrar General's Office and regular visits by Bank of Ghana's officials. Rural banks are expected to submit a weekly statement of reserves, assets and deposits, liabilities, balance sheet and quarterly returns on loans and overdrafts.

## 2.13 The credit function of rural banks

Rural banks are obliged to grant credit for viable projects within the community in which they operate. Aside this, the Bank of Ghana’s credit manual for rural banks outlines other objectives of the rural banks. The manual further specifies certain requirements that must be fulfilled by applicants. According to Miller and Van Horne (1993), these objectives are savings mobilisations, profit mobilisation and plans to raise the standard of living of the rural folks.

In the first place, the applicant must be a customer of the bank for at least six months, holding either a savings or a current account. The personal traits of the applicant must be accessed before being given credit. Such traits include honesty, integrity and reputation of the applicant in the community.

The next is the progressing competence which the applicant must demonstrate. The applicant must appear to be physically and mentally sound and posses an unquestionable history regarding debt payment.

Finally, the applicant must show actual need for credit through a convincing description of the purpose for which the credit facility is required, the actual amount and the period the facility is needed must be specified. The applicant is also expected to explain the sources from which repayment shall be made.

For group loans, the lender must satisfy the above requirements and the rest who do not possess an account must open a savings account together with the loan application of the group. For government agencies and members of board of directors of rural banks, such applications shall be referred to the Bank of Ghana for clearance. For an agricultural loan, a farmer or an organised group of farmers who are cultivating land allocated for the cultivation of vegetables and staple crops, the acreage under cultivation should not exceed ten acres and hundred respectively. In the case of an industrial loan, the applicant must be an operator of a rural based industry and producing those goods and commodities which have a ready market within or outside the community. In the case of commercial overdraft, the applicant should be a retailer or a wholesale merchant known in the community and operating a current account with the rural banks.

The manual provides that, land or other fixed assets such as building or a private vehicle not to be used for the benefit of the community should not be financed by a rural bank credit as well as luxury goods.

## 2.14 Lending procedures in rural banks

The Bank of Ghana's credit manual contains the mandatory sectarian allocation priorities set in the guidelines established by the Bank of Ghana. The breakdown is as follows: Agriculture; a maximum of 50% of total credit, cottage industry 30% approximately, trade and transport 20% maximum. The project officer is responsible for studying all applications and arranging for an appraisal or implementation visit. Completing the application and appraisal report constitutes the investment feasibility report. Recommendations as to whether an application should be considered or not then follows. The approval process is the responsibility of the bank manager if the amount is within the authorised limit. If it exceeds the limit, he forwards it to the loans committee or board at a meeting.

## 2.15 Credit life time

According to Mwine (1995), rural banks have the following credit periods.

1. **Operational period:** This period is when actual monitoring has to be done until the loan or overdraft has been fully recovered.

2. **Review period:** The manager, at least once in a month, has to go through the loan and current account to make sure that payment is recorded. He must observe the progress of the undertaking or the project financed by the banks. In case of default, the manager has to take action (Bank of Ghana Manual, 2006).



## 2.16 Summary

The researcher examined credit risk management at the South Akim Rural Bank in Koforidua. A major source of bank revenue is loan interest from customers. When loans are given out especially to the bank’s customers, economic activities are facilitated. Ways in which loans are given out, associated risk and the influence on economic activities were discussed in the literature through a description of credit, forms and importance of credit, risks associated with lending, credit risk management, procedure involved in lending, the regulatory framework of rural banks, registration of rural banks, supervision, the credit function of rural banks and lending procedures among others. It was noted that when loans are given out timely and in the required quantum and loan interests are paid when due, the giving and re-payment of loans keep enough money in the system and therefore connect to boost economic activities.

# CHAPTER THREE

## M E T H O D O L O G Y

### 3.1 Research design

The research design that was used in this study was a descriptive survey. In a descriptive survey, samples are drawn from the population of interest and based on a description of variables of interest with respect to the research topic and respondents' responses, guided generalisations are made about the population. A descriptive survey 'permits the asking of the same set of questions often in the form of written questionnaires to a large number of respondents either by mail, telephone or in person' (Fraenkel and Wallen, 2002: 11). Descriptive survey was used by asking the respondents of the South Akim Rural Bank in Koforidua the same set of questions on credit risk management and related issues. This was meant to facilitate the achievement of the research objectives.

### 1. Profile of study organisation

The South Akim Rural Bank in Koforidua was selected for the study. The bank is one of the traditional rural banks in the country and a major player in the industry with the mother bank having agencies spread all over the Eastern Region of Ghana and beyond. Again, the bank has operated successfully over the years and has won several awards. The Koforidua branch of the bank was selected for the study because it has all the various departments that will make it possible to get respondents from all areas of the bank's operations.

The organisational structure of the bank is as follows.

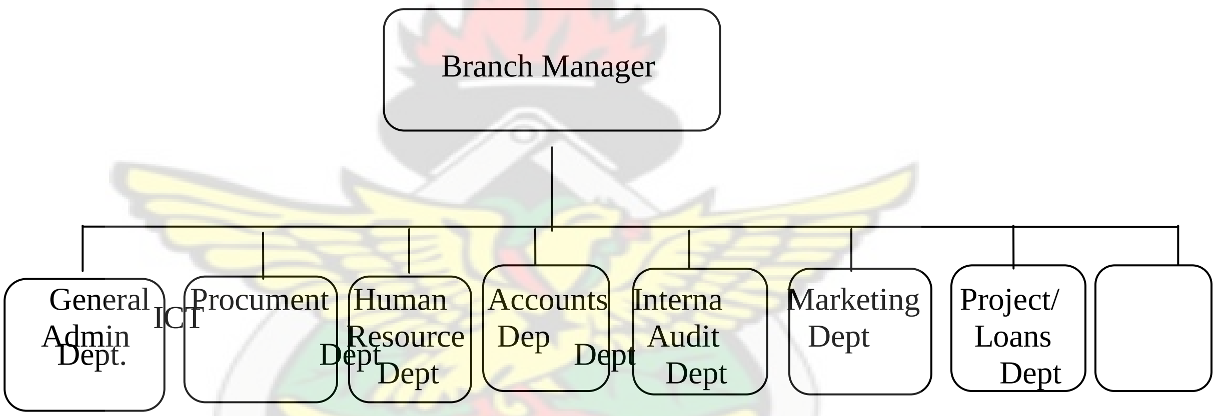



**Figure 1: Organisational structure of the South Akim Rural Bank**

Source: South Akim Rural Bank, 2012

The organisational chart shows the relationships that exist among the employees as well as the directional flow of communication at the South Akim Rural Bank in Koforidua. Policy issues emanate from the Branch Manager to the departments and feedback on the extent of implementation is reported from the departments to the Branch Manager.

### 3.2 Population

According to Agyedu, Donkor and Obeng (1991), population refers to the complete set of individuals, objects or events that have common observable characteristics in which a researcher is interested. The population for this research was the management staff of the South Akim Rural Bank in Koforidua and customers of the bank.

Table 1 depicts the employees and the departmental breakdown of the study organisation.

**Table 1: Employees and departmental breakdown of the South Akim Rural Bank**

| Employees | No. |
|---|---|
| General Administration | 11 |
| Human Resource | 2 |
| Accounts | 3 |
| Internal Audit | 2 |
| Marketing | 2 |
| Project/Loans | 2 |
| ICT | 3 |
| Procurement | 2 |
| Total | 27 |

Source: South Akim Rural Bank, 2012

The South Akim Rural Bank in Koforidua has eight departments. The departments and the breakdown of employees, in brackets, are as follows: General Administration (11), Human Resource (2), Accounts (3), Internal Audit (2), Marketing (2), Project/Loans (2), ICT (3) and the Procurement Departments (2). The total strength of employees at the branch is twenty-seven (27). Out of this number, the Branch Manager (1), Human Resource Officer (1), Accountant (1), Internal Auditor (1), Marketing Officer (1), Project Officer (1), ICT Officer (1) and the Procurement Officer (1) constitute the Management team.

## 3.3 Sample and sampling procedures/techniques

The list of management staff at the South Akim Rural Bank in Koforidua and the customers of the bank constituted the sampling frame.

Purposive and random sampling methods were used to select the sample for the study. The Branch Manager, Human Resource Officer, Accountant, Internal Auditor, Project/Loans Officer, Marketing Officer, ICT Officer and the Procurement Officer were purposively selected for the study because their roles at the bank put them in a position to provide certain information required to achieve the research objectives. The other respondents included in the sample were one hundred and twenty (120) and they were selected from the customers of the bank numbering approximately eight hundred and forty (840) through the method of systematic sampling. The researcher positioned himself at the entrance of the bank and picked each seventh customer who entered between 9.00 am and 12.00pm as a respondent for the study. February 27th to March 9th, 2012 was set aside for this exercise because it was a peak period where most customers came to withdraw salaries and do other transactions. The eight (8) Management staff purposively selected and the one hundred and twenty (120) customers chosen through systematic sampling and totalling one hundred and twenty-eight (128) were used as respondents for the study.



## 3.4 Data collection tools/procedures

Questionnaires and a structured interview guide were used as the tools for the collection of data. The questionnaires were divided into five sections; A, B, C, D and E. Section A comprised of questions on the bio data of the respondents. Section B focused on the qualification requirements of customers for loans. Section C dwelt on issues relating to the processes used in granting loans to customers. Section D had questions on the problems encountered by the bank in an attempt to recover loans from customers and Section E had questions on the measures used by the bank to enhance loan recovery and reduce credit risk.

Pre-testing was carried out to test the validity and reliability of the questionnaires designed for data collection. The pre-testing was done using management and customers of the bank at Nankese as the researcher was on an assignment there. The responses received were consistently close to or same as those anticipated. The questionnaires were therefore considered valid and reliable for data collection and the pre-test samples were also included in the final samples.

To facilitate the data collection, a letter of introduction was obtained from the Institute of Distance Learning, Kwame Nkrumah University of Science and Technology and visits were made to the South Akim Rural Bank in Koforidua to inform the Management about the data collection exercise. A date was scheduled and a suitable time agreed upon for explaining the essence of the research to respondents. In the process, respondents were assured about the confidentiality of the exercise. The researcher personally administered the questionnaires to the various respondents and one week was used to collect the entire data.

A structured interview guide was also used for the Branch Manager, Human Resource Officer, Internal Auditor, Project/Loans Officer, Marketing Officer, ICT Officer, Logistics Officer and the Accountant because of their work schedule. The questions focussed on the research objectives and research questions. The questions were read out to the respondents and the responses given were ticked accordingly. The interview ended with an examination of some documents on credit risk management from the bank.

## 3.5 Data analysis/presentation procedure

The data from the respondents was first edited. Individual items on the questionnaires were edited in line with the responses given. The raw data was then organised bearing in mind the research questions for which the instruments were designed. Analysis of the data involved the coding of items in the questionnaires and feeding them into a computer for analysis. Descriptive statistics in the form of frequencies and percentages were used in presenting the data and these were combined with tools from the Statistical Product and Service Solutions (SPSS) software to analyse the data gathered. Pictorial representations were also used to make the descriptions more vivid.



# CHAPTER FOUR

# RESULTS AND DISCUSSION

## 4.1 Introduction

This chapter presents the results and discussion of the data collected from respondents on credit risk management at the South Akim Rural Bank in Koforidua. The analysis and discussion of the results focused on the objectives of the study.

## 4.2 Bio data of respondents

A study of the bio data of respondents revealed the following details which relate to their gender and age.

**Table 2: Distribution of respondents by gender – Bank staff**

| Sex | Frequency | Percentage |
|---|---|---|
| Male | 6 | 75.0 |
| Female | 2 | 25.0 |

| | | |
|---|---|---|
| Total | 8 | 100.0 |

Source: Field survey, 2012

The above information can be presented in the form of a pie chart as follows:



**Figure 1: A pie chart showing the distribution of respondents by gender – Bank Staff**

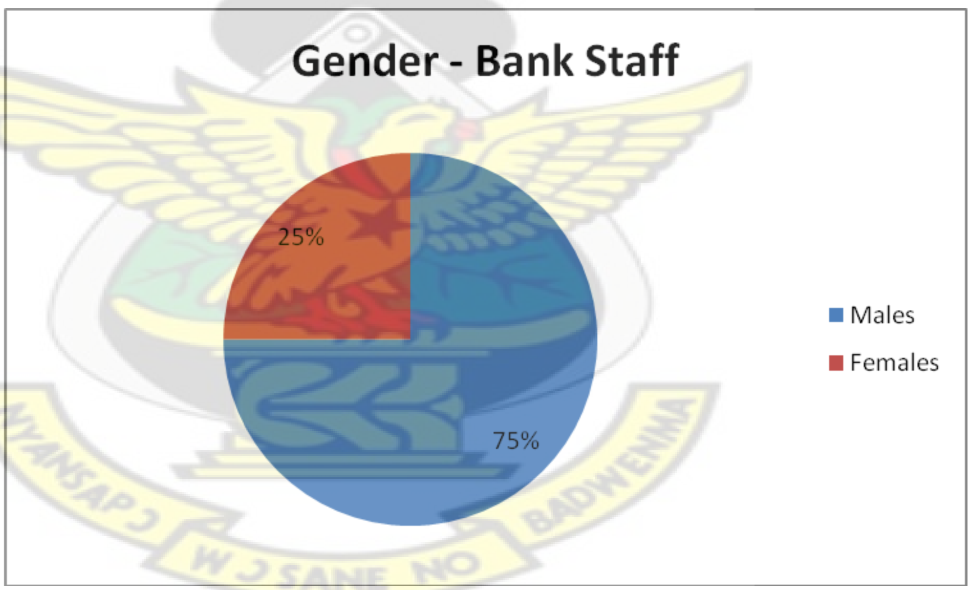



Table 3 and the pie chart in figure1 indicate that of the total number of bank staff who were chosen as respondents, male employees were 75.0% as against 25.0% who were female employees.

The distribution by gender of the other respondents in the sample is shown in Table 3.

**Table 3: Distribution of respondents by gender – Customers**

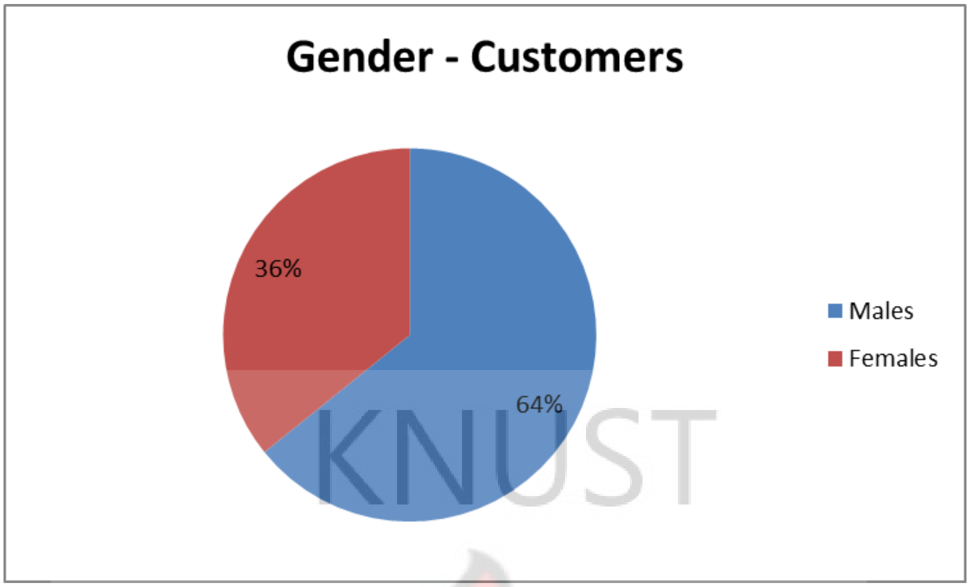
| Sex | Frequency | Percentage |
|---|---|---|
| Male | 77 | 64.2 |
| Female | 43 | 35.8 |
| Total | 120 | 100.0 |

Source: Field survey, 2012



Similarly, male respondents were 64.2% and female respondents totalled 35.8% as indicated in Table 4 for respondents who were customers and the above information is presented in the form of the pie chart that follows:

**Figure 2: A pie chart showing the distribution of respondents by gender – Customers**




In response to the employment status of customers, it came to light that 48.0% were employed in the formal sector while 52.0% were engaged in the informal sector.

Questions were asked about the level of education of the respondents (customers) and the responses obtained showed that 23.0% had tertiary education, 46.0% had SHS level education, 9.0% basic and JHS level education and 12.0% had non-formal education and 10.0% had no education at all. The respondents therefore generally have a level of education that is adequate to enable them appreciate simple bank transactions.

Table 4 also indicates the ages of respondents.

**Table 4: Age distribution of respondents**

| Age (Years) | Frequency | Percentage | Degree Equivalent |
|---|---|---|---|
| 10 - 19 | 4 | 3.1 | 11.3 |

| | | | |
|---|---|---|---|
| 20 – 29 | 12 | 9.4 | 33.8 |
| 30 – 39 | 17 | 13.3 | 47.8 |
| 40 – 49 | 63 | 49.2 | 177.2 |
| 50 – 59 | 18 | 14.1 | 50.6 |
| 60 – 69 | 11 | 8.6 | 30.9 |
| 70 - 79 | 3 | 2.3 | 8.4 |
| Total | 128 | 100.0 | 360 |

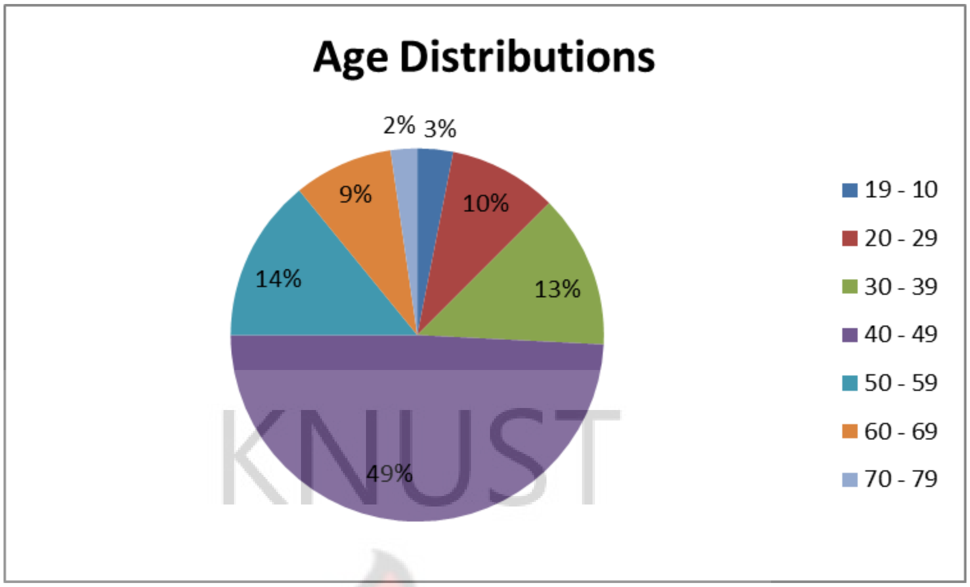
Source: Field survey, 2012

The ages as shown in Table 4 above was at respondents' last birthday and these ranged from between 10 to 79 years. The details presented in Table 5 cover all the respondents – both the bank staff and customers.

An examination of the age distribution shows that the age range 40 – 49 years has 63 respondents (49.2%) an indication that most of the customers of the bank have more years of work life and unless they change banks, would help sustain the operations of the bank.

The above information is presented in the form of a pie chart as follows:

**Figure 3: A pie chart showing the age distribution of respondents**






## 4.3 Qualification requirements of customers for loans

To obtain and analyse responses on qualification standards for loans, the questions that follow were asked the customers totalling 120 only and the responses obtained have also been analysed as appropriate.

In response to whether the customers selected as respondents were familiar with the processes of obtaining loans from the South Akim Rural Bank in Koforidua, 69.0% said yes while 31.0% responded in the negative. Those who had some knowledge were further asked to indicate what these processes are and they mentioned that the applicant has to be a worker or customer of the bank, must have a required minimum deposit in his account, submit an application letter and must be properly appraised before the loan is approved.

Respondents were also asked to indicate how often the bank communicates its lending rate to customers. The responses obtained are shown in Table 5.

**Table 5: Frequency of communication of the bank's lending rate**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 5 | 4.2 |
| Often | 8 | 6.6 |
| Sometimes | 87 | 72.5 |
| Seldom | 20 | 16.7 |
| Not at all | 0 | 0.0 |
| Total | 120 | 100.0 |

Source: Field survey, 2012

As indicated in Table 5, 72.5% representing the majority stated that the bank's lending rate is only sometimes communicated to them while 16.7% stated that the communication is only seldom and 10.8% said the bank 'very often' to 'often' communicate its lending rate to customers.

**Table 6: Customers who have taken loans from the bank**

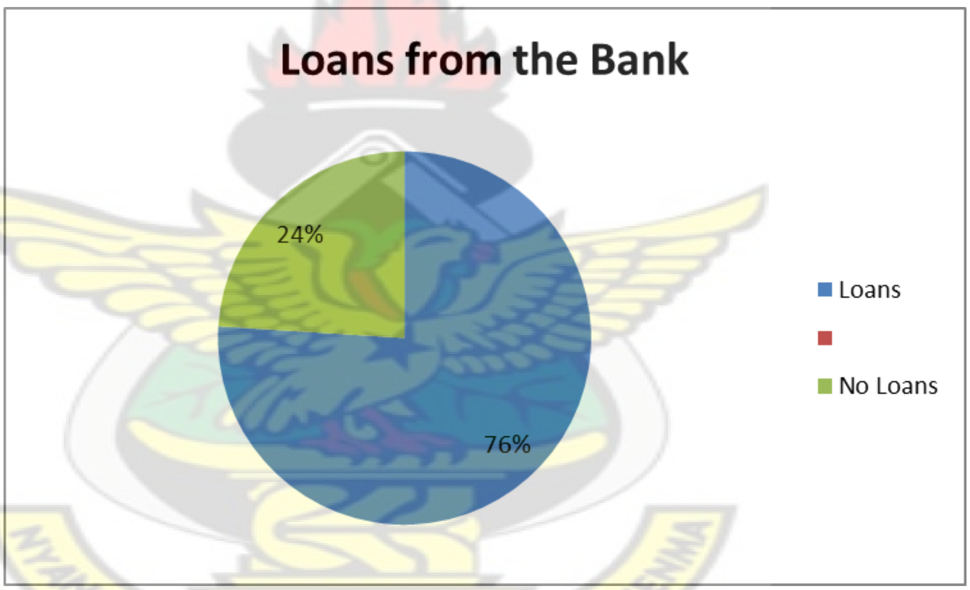
| **Response** | **No. of respondents** | **Percentage (%)** |
|---|---|---|
| Have taken loan (s) | 97 | 75.8 |
| Have not taken loans | 23 | 24.2 |
| **Total** | 120 | 100.0 |

Source: Field survey, 2012

From Table 6, it is noted that 75.8% of respondents indicated that they have benefitted from some form of credit from the bank before and 24.2% had not taken any loans from the bank before. This is an indication that the bank advances credit to its customers and lots of customers benefit from such loans.

The above details are shown in the pie chart below.

**Figure 4: A pie chart showing customers who have taken loans from the bank**




The fact that the bank gives loans to a variety of customers is supported by Miller and Horne (1993) who intimate that where loan administration is properly handled by the management of a financial institution, it is able to rake in adequate loan interest to support its development objectives and also remain very competitive in the industry.

Respondents were asked to give reasons why they sometimes default in the repayment of loans and their responses are captured in Table 8.

**Table 7: Customers reasons for loan re-payment default**

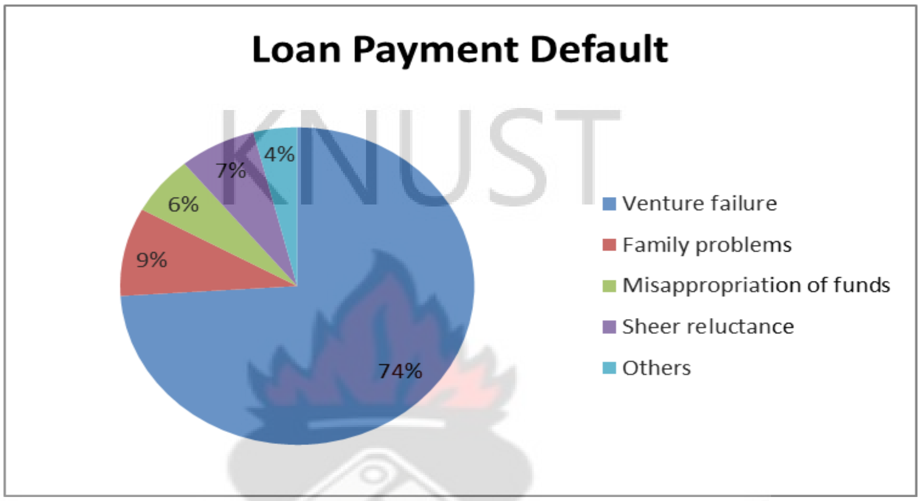
| **Response** | **No. of respondents** | **Percentage (%)** |
|---|---|---|
| Venture failure | 89 | 74.2 |
| Family problems | 11 | 9.2 |
| Misappropriation of funds | 7 | 5.8 |
| Sheer reluctance | 8 | 6.6 |
| Others | 5 | 4.2 |
| **Total** | 120 | 100.0 |

Source: Field survey, 2012

From Table 8, it is noted that a number of factors account for loan payment defaults. However, from the responses obtained, the most pronounced is venture failure with a percentage of 74.2%. Maness (1990) suggests that ill-advice, wrong choice of jobs, unskilled and lazy staff and the inability to attract and retain customers are all factors that might result in business failures.

The information above is represented in the pie chart in figure 6.

**Figure 5: A pie chart showing reasons for loan re-payment default**




Though some of the loan beneficiaries were quick to indicate that controls for the granting of loans by the bank were strict, such measures could still be improved upon and that a higher level of efficiency could be brought about in the bank's operations in the area of loans administration. Mwime (1995) suggests that where a bank has strict controls for the giving of loans to customers and these are complied with, it reduces how much goes into bad debts.

## 4.4 Credit risk factors and problems of loan recovery

The Manager, Human Resource Officer, Accountant, Internal Auditor, Loans/Projects Officer, Marketing Officer, ICT Officer and the Procurement Officer were also asked to provide some responses on issues on processes for granting loans, credit risk factors and problems encountered in loans recovery effort together with measures for loan recovery and credit risk reduction. Their responses are discussed below. The manager and the seven other staff above when interviewed mentioned that the bank supports the agricultural, construction, manufacturing and service sectors with

loans. In addition to these sectors, the bank also supports commerce, provides various forms of personal loans and is also into micro financing. In all these sectors, credit is extended to both salaried and non-salaried customers.

The responses of the staff further indicated that the bank gives short-term, medium-term and long-term term loans with the short-term loans usually given for a period of up to three months, the medium-term from three months to one year and the long-term from one year to three years and above.

When the question was asked about the eligibility requirements for loans from the bank, the responses obtained from all the 8 respondents suggested the procedures outlined below:

1. The applicant must be a worker and customer of the bank.
2. The applicant must have a minimum amount of thirty-three percent (33%) of the required loan in his or her account.
3. The applicant must submit an application letter in writing and this must be signed or thumb printed.
4. The applicant must be properly appraised by the loans/project officer on the information gathered through credit investigation.

5. Applicants who have overdue accounts with the bank are not eligible for new loans.
6. The applicant must fill the required loan form fully.

An important document that was perused at the end of the interview was the bank's annual reports from 2008 to 2010. It contained the loans granted to various sectors in these years and provided a very useful insight for the study.



**Table 8: Loans granted to customers from 2008 to 2010**

| **Sectors** | **Year 2008** | **Year 2009** | **Year 2010** |
|---|---|---|---|
| Agriculture | 98,721 | 106,533 | 166,626 |
| Commerce | 1,902,165 | 2,007,909 | 2,245,035 |
| Transport | 222,039 | 290,799 | 380,556 |
| Cottage Industries | 18,372 | 5,022 | 2,257,458 |
| Miscellaneous | 1,181,829 | 1,471,119 | 64,023 |
| **Total** | **3,423,126** | **3,881,382** | **5,113,698** |

Source: South Akim Rural Bank, Annual Reports 2008, 2009 and 2010

As shown in Table 8, the bank extends most of its loan facilities to sectors comprising of agriculture, commerce, transport, cottage industries and others. In the year 2008, 2009 and 2010, the highest amount of loans went to commerce with percentages of 55.6%, 51.7% and 43.9% respectively and though the figures keep reducing from one year to the other, loans to that sector still remained highest. In the case of the cottage industries sector, it started with the least percentage (0.5%) of loans in 2008, but ended up in 2010 with the highest percentage (44.1%) a situation which appears to suggest an increase in the level of activity in this sector.

The study also sought to ascertain the categories of customers that loans are granted to. Their responses are captured in Table 9.

**Table 9: Categories of customer that credit is advanced to**

| **Response** | **No. of respondents** | **Percentage (%)** |
|---|---|---|
| Current Account Holders | 7 | 87.5 |
| Savings Account Holders | 1 | 12.5 |
| Fixed Deposit Holders | 0 | 0.0 |
| Treasury Bills Customers | 0 | 0.0 |
| Others | 5 | 0.0 |
| **Total** | 8 | 100.0 |

Source: Field survey, 2012

From Table 9, one staff mentioned that savings account holders could be given loans. This represents 12.5%. All the 7 remaining respondents or 87.5% interviewed suggested that most of the time salaried earners or those who save at the bank and could provide collateral against loans were often given loans.

In response to the question about how long a customer of the bank had to wait in order to qualify for a loan, all the 8 respondents agreed that up to six months of opening especially a current account with the bank, a customer could be granted a loan.

On the question of whether the bank has a system of screening loan applicants before loans are given to them, the 8 respondents answered in the affirmative and went ahead to indicate that the most common screening method was an evaluation of the nature of the applicant's job in order to ascertain if he has a regular income which is sustainable. All the loan applicants are then evaluated through a system of credit rating and ranked for qualification. Depending on how much deposit each individual has in his account, they are given a loan that is proportional to it.

The respondents who are employees of the bank were also asked to identify the most common credit risk factors or specify problems that they encounter in the bank's effort to recover loans from the loan beneficiaries and their responses are discussed below:

When the respondents were asked if they faced problems with the customers in terms of loans repayment, all of the 8 respondents stated that they sometimes do. Some of the problems stated include locating the debtors after they have taken the loans, misapplication of the loans or in some cases, failures of the businesses for which the loans are obtained. The interview also reviewed that the bank has laid down procedures for granting credit and the procedures are reviewed every five years.

## 4.5 Measures of loan recovery and credit risk reduction

The employees *w*ere also asked to indicate measures of loan recovery and credit risk reduction and their responses are discussed below. Specifically, the respondents were to indicate how often compensating balance, collateral security, stringent management, strict enforcement of restrictive covenant, law suits, credit insurance, guarantees and syndication and participation were used as measures of loan recovery and credit risk reduction and their responses are discussed below.



**Table 10: The use of compensating balance as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 0 | 0.0 |
| Often | 0 | 0.0 |
| Sometimes | 8 | 100.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

As evident in Table 10, all the 8 respondents indicated that compensating balance is only sometimes used by the bank as a measure of loan recovery and credit risk reduction.

**Table 11: The use of collateral security as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 4 | 50.0 |
| Often | 4 | 50.0 |
| Sometimes | 0 | 0.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

As evident in Table 11, 4 respondents representing 50.0% indicated that collateral security is very often used by the bank as a measure of loan recovery and credit risk reduction. The remaining 4 respondents also representing 50.0% indicated that collateral security is often used by the bank as a measure of loan recovery and credit risk reduction.

To obtain, analyse and discuss whether stringent management is a measure of loan recovery and credit risk reduction that used at the bank, responses were required of the Management staff used in the study. What they provided is indicated in Table 10 below.

**Table 12: The use of stringent management as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 1 | 12.5 |

| | | |
|---|---|---|
| Often | 7 | 87.5 |
| Sometimes | 0 | 0.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012



Table 12 shows that 100.0% of the respondents agreed that ‘very often’ and ‘often’, stringent management practices are used by the Management of the bank to reduce credit risk.

Respondents were asked to indicate if the strict enforcement of restrictive covenant is used by the bank as a measure of loan recovery and credit risk reduction and their responses suggested that Management does not use restrictive covenants in their loan recovery and risk recovery drive.

On the issue of whether loan repayment defaulters are sent to court for prosecution, what was obtained as respondents’ responses are presented in Table 13.

**Table 13: The use of law suits as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 0 | 0.0 |
| Often | 0 | 0.0 |
| Sometimes | 8 | 100.0 |
| Seldom | 0 | 0.0 |

| | | |
|---|---|---|
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

Sending loan re-payment defaulters to court for prosecution seems to be one of the last measures that most banks use to recovery loans. For this reason, it was not very surprising when all the 8 respondents agreed that Management only sometimes use law suits to recover loans. According to Caprio and Klingebel (1996), the use of courts to recover money that has been given out as loans is lawful. However, where such use is frequent, continuous or persistent, it discourages most potential customers from transacting businesses with the bank.

Views were also sought on whether the Management of the bank uses credit risk insurance as a measure to protect the money usually advanced to customers as loans and the responses obtained have been put together in Table 14.

**Table 14: The use of credit insurance as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 0 | 0.0 |
| Often | 0 | 0.0 |
| Sometimes | 8 | 100.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

Table 14 shows that all the 8 respondents were unanimous in stating that credit insurance is not a popular arrangement used by the bank as a measure for the recovery of loans and the reduction of credit risk. Probably because insurance schemes are not generally likeable by the citizenry mostly because of issues of claims payment, banks also find it not very attractive to dabble in it to any large extent.



The issue of the use of guarantees for credit risk management was also examined and the responses obtained have been presented in Table 15.

**Table 15: The use of guarantees as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 8 | 0.0 |
| Often | 0 | 0.0 |
| Sometimes | 0 | 100.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

All the 8 respondents representing 100.0% responded that very often guarantees are used to limit the risk involved in advancing loans to customers. To them, the usual practice is for a loan applicant to arrange to get two people who are also customers of the bank to assent to the loan request by signing a column on the loan application form.

Respondents were further requested to indicate whether Management of the bank uses syndication and participation as a measure of loan recovery and credit risk reduction. The responses obtained are presented in table16.

**Table 16: The use of syndication and participation as a measure of loan recovery and credit risk reduction**

| Response | Frequency | Percentage |
|---|---|---|
| Very often | 0 | 0.0 |
| Often | 0 | 0.0 |
| Sometimes | 8 | 100.0 |
| Seldom | 0 | 0.0 |
| Not at all | 0 | 0.0 |
| Total | 8 | 100.0 |

Source: Field survey, 2012

As evident in Table 16, all the 8 respondents mentioned that the bank only sometimes uses syndication as a measure of loan recovery and credit risk reduction. From all the responses obtained from the respondents on the measures of loan recovery and credit risk reduction, it came to the fore that the use of collateral, stringent management and guarantees are the measures that are very often used by the bank for loans recovery and the management of credit risk.

# CHAPTER FIVE

# CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Introduction

This chapter presents a summary of the study. It covers the major findings, conclusions arrived at and the recommendations made. The study examined credit risk management at the South Akim Rural Bank in Koforidua by focusing on four main objectives. Descriptive survey was used for the research and a sample of one hundred and twenty-eight (128) was selected for the study through the purposive and systematic sampling methods.

## 5.2 Summary of findings

The study dealt with four specific objectives. The first and second objectives were on the assessment of the qualification standards of customers for loans and the bank's processes for granting loans. The key findings are:

Most of the customers (69.0%) were familiar with the processes for granting loans and they mentioned some of these to include that the applicant had to be a customer of the bank, must have an expected minimum deposit in his current account, must submit an application letter and must be properly appraised before the approval of his loan.

Another key finding was that the qualification requirements for loans are only sometimes made known to potential loan applicants. This is supported by the 72.5% responses from the respondents. This notwithstanding, the study showed that 80.8% of customers have taken loans from the bank but when it comes to the re-payment of such loans, most of them default.

The third objective that was addressed by the study was the problems encountered in the bank's attempt to recover loans from customers. With respect to this objective, the study revealed that most current account holders and a very few savings account holders are usually given short-term, medium-term and long-term loans of substantial sums however, most of such customers default in loan re-payment mainly as a result of failures of the businesses they invest in together with other subsidiary reasons such the misappropriation of the loans and sheer reluctance to pay back to the bank.

The fourth objective was to examine the measures in place to enhance loan recovery and credit risk reduction at the bank. With respect to the objective, the study found out that though the South Akim Rural Bank in Koforidua uses compensating balance, collateral security, stringent management, strict enforcement of restrictive covenant, law suits, credit insurance, guarantees as well as syndication and participation, by far, the most often used measure of credit risk reduction is through the collateral security, guarantees and stringent management practices.

## 5.3 Conclusions

The management of credit risk is a big issue at the South Akim Rural Bank in Koforidua. With respect to the processes for loan application customers indicated adequate familiarity with these but the same customers were not completely familiar with the requirements that could qualify one for a loan. A number of problems were identified for customers' reluctance to repay their loans and the most outstanding was the issue of venture failures and though there were some measures in place at the bank for the reduction of the risks associated with credit, such measures did not seem to be very effective,

## 5.4 Recommendations

Based on the findings of the study and the conclusions drawn from it, certain issues need to be addressed.

Management has to hold frequent meetings to review qualification standards for loans and these must be well communicated from time to time to customers.

Again the processes for granting loans must be reviewed periodically and in doing this, the input of key customers must be solicited. When done information should be passed on to customers especially using the bank's notice board.

As venture failures was noted to be the key problem that often created the greatest risk of non-payment of loans, Management could set up an advisory board of experts who would take up the responsibility of advising and guiding potential loan beneficiaries about appropriate investment opportunities that assure a reasonable return so that the risk of non-payment of loans could be minimised.

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**APPENDIX A**

**QUESTIONNAIRE AND INTERVIEW GUIDE**

**KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**INSTITUTE OF DISTANCE LEARNING**

This is a study on the management of credit risk and your bank has been selected as an access institution because of the assistance it provides to customers in its catchment areas. A number of issues have been identified and your candid responses will be duly appreciated. You are assured that this is purely for an academic exercise and your responses and records will be treated confidentially.

**SECTION A:** Bio data

(Please provide the required answer(s) or tick [ ] as appropriate).

1. Name of Department..........................................................................................................
2. Sex: Male [ ] Female [ ]
3. Age (As at last birthday)........................................................................................
4. Highest academic qualification:.............................................................................



**SECTION B:** Qualification requirements for loans at the South Akim Rural Bank

5. Have you applied for a loan from the South Akim Rural Bank before?

   Yes [ ] No [ ]

6. If you answered 'no', to question 5, please provide reasons why.....................................

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7. If you answered 'yes' to question 5, were you given the loan?

   Yes [ ] No [ ]

8. If you answered 'no', state below the reasons why your application was not successfully.

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9. How does one qualify to obtain a loan from the bank?

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10. Do you think the qualification requirements are satisfactory?

Yes [ ]                    No [ ]

11. Give reasons for your choice of answer in question 10.

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**SECTION C:** Processes used for granting loans to customers of the bank

12. What categories of customers are given loans by the bank?

13. How long must one be a customer to qualify for a loan facility?

14. Does the bank has a system for screening loan applicants?

Yes [ [                    No [ ]

15. If you answered 'yes' to question 14, please indicate what applicants are screened for

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16. Specify the processes that are used in granting loans to customers.

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17. Are interest rate values communicated to potential loan applicants?

Yes [ [ No [ ]

**SECTION D:** Problems encountered by the bank in its loan recovery effort

18. Does the bank encounter any problems in its attempt to recover loans from customers?

Yes [ [ No [ ]

19. If you answered 'no' to question 18, what factors account for this?

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20. If you answered 'yes' to question 18, state the problems encountered by the bank in its attempt to recover loans from customers.

21. Which of the problems do you think are most pronounced?

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**BANK STAFF ONLY**

**SECTION E:** Measures used by the bank to manage credit risk

22. How is credit risk managed at the South Akim Rural Bank?

23. Indicate how often the following credit risk management measures are used by the South Akim Rural Bank.

| **Items/Responses** | **Very often** | **Often** | **Sometimes** | **Seldom** | **Not at all** |
|---|---|---|---|---|---|
| Compensating balance | | | | | |
| Collateral security | | | | | |
| Stringent | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| management | | | | | |
| Strict enforcement of restrictive covenant | | | | | |
| Law suits | | | | | |
| Credit insurance | | | | | |
| Guarantees | | | | | |
| Syndication and Participation | | | | | |