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## **FACULTY OF COMMERCE**

### **DEPARTMENT OF ACCOUNTING**

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**LEVEL 4.2(PDP)**

An Investigation into Credit Risk Management on Non-Performing Loans in Microfinance  
Institutions. A case of Zimbabwe Microfinance Fund (ZMF) 2017 - 2018

Dissertation submitted in partial fulfilment of the requirements of the Bachelor of Commerce  
Honors in Accounting Degree

## **RELEASE FORM**

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**DEGREE IN WHICH DISSERTATION WAS PRESENTED:** AN INVESTIGATION INTO CREDIT RISK MANAGEMENT ON NON PERFORMING LOANS IN MICROFINANCE INSTITUTIONS .

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## APPROVAL FORM

The undersigned certify that they have supervised the student **R143936P** dissertation entitled, “An Investigation into Credit Risk Management on Non-Performing Loans in Microfinance Institutions. A case of Zimbabwe Microfinance Fund ( ZMF) 2017 – 2018, in partial fulfillment of the Bachelor of Commerce Honors in Accounting Degree at the Midlands State University

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## **DEDICATION**

I dedicate this research to my family and friends who gave me support and encouragement during my study.

## **ACKNOWLEDGEMENTS**

To the Lord Almighty, glorified be his name, for he brought me this far, giving me wisdom and understanding during my research.

## **ABSTRACT**

The research sought to investigate into credit risk management as a tool to bring down the level of non-performing loans in Microfinance Institutions .A case of Zimbabwe Microfinance Fund (ZMF) .The study is arranged starting with the introduction of the chapter which was followed by the background of the study highlighting factors related to credit risk management and non performing loans. Statement of the problem will show what triggered the researcher to carry out such a research. Finally the conclusion will elaborate on the findings, conclusions made and recommendations that can be adopted to bring down the level of non -performing loans.

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# CHAPTER 1

## 1.0 Introduction

This chapter serves as an introduction to the study highlighting why the research is being undertaken, what the research aims to achieve and how the research is significant and concludes by giving a definition of terms and a summary.

## 1.1 Background of study

A nonperforming loan(NPL) is the sum of borrowed money upon which the debtor has not made his scheduled payments and is more than 90 days due , and at this stage the odds of being repaid are substantially lower (Rajha ,2017). NPLs have been one obstacle that hinder MFIs from functioning effectively as they force institutions to scale down their lending activities and at times cease operations (Khandler,2013), as is the case with institutions such as Collective Financial Services (CFS), Virgin Microfinance and First Choice Microfinance which failed to survive after crippling to non-performing loans.

Every lending institution finds itself from time to time with loans in their portfolio for which the risk of loss is greater than the anticipated when the loan was made(Bercoff et al. 2002).For instance, according to the Monetary policy statement of 2017, a total of 295547 loans were classified to be outstanding as at 30September 2017 in the microfinance sector and were attributed to the failure of borrowers to pay back their loan advances.Moti et al(2012)elaborates that the rising levels of non- performing loans in the global market for the last 10 years, is a trend that not only threatens the viability and sustainability of the MFI's but also hinders the achievement of targeted goals. NPLs are evidenced through poor loan qualities, liquidity crises, diminished profitability and are a reflection of an unsound financial sector in an economy. (Lopatta & Tchikov 2016)

Microfinance is a sustainable means of poverty alleviation leading to lasting, holistic development (Lopatta and Tchikov, 2016). Robinson (2001) pointed out that microfinancing

began as highly subsidized rural credit programs in rural areas in the 1950s and has evolved to be one powerful tool for financial inclusion, filling the gap in formal intermediation and is a nexus for economic growth (Rai, 2015). Zimbabwe has been experiencing a major economic downturn for the past decade as reported by the World Bank in Zimbabwe in an article titled Zimbabwe Reconstruction Fund (2017). The economic downturn experienced in the late 1990s lead many people to engage in informal activities to earn a living and as such, microfinance activities increased with demand for micro to small loans (Zimbabwe Association of Microfinance Institutions (ZAMFI), 2014).

As the demand of microfinancing increases, there is need to balance growth and managing credit risk and as such, the concept of credit management became widely appreciated by MFI's in the late 90s (Moti et al, 2012). Credit risk is the financial exposure resulting from a microfinance institutions dependence on another party to perform an obligation as agreed and encompasses loss of income resulting from the MFIs inability to collect an anticipated interest earnings as well as the loss of principal resulting from loan defaults (Ahmed and Malik, 2015). ZAMFI (2017) reports that MFIs in Zimbabwe have largely been engaged in high risk lending especially to consumers who have been mitigating their meagre salaries by borrowing and considering events such as retrenchments in the private sector the default rates have increased as the borrowers fail to perform an obligation agreed on and MFIs are encompassing losses of income resulting from the MFIs inability to collect an anticipated interest earnings as well as the loss of principal resulting from loan defaults.

Credit risk has gained focal importance because of rising levels of bad loans as alluded by Frank et al (2014) and further indicates that microfinance institutions need to have strong credit risk management policies for ensuring consistent recoveries from clients. Andryushchenko et al (2015) stresses out that credit is the main source of income for MFIs, which is why they need to have strong policies for credit risk management to be sustainable and profitable. Studies by Lassoued (2017) and Zafar et al (2017) have revealed that credit risk affects the profitability and the general performance of MFIs. Mulumba (2011) researched about credit policy managerial

competence and customer retention in microfinance institutions and alluded that proper financial management of MFIs is positively related to loan performance. The argument finds credence since failure to monitor portfolio quality closely and take action when necessary accounts for poor loan performance as alluded by Adongo (2012). In developing countries and like in Zimbabwe, the focus has been on microfinance as a catalyst for poverty eradication and economic growth. It is against the identified gap in literature that the study is to be conducted and will aim at analyzing credit risk management to reveal gaps that will help institutions to put in place robust credit management systems that will help bring down the level of nonperforming loans which have been saddling the sector.

The company in study, Zimbabwe Microfinance Fund (ZMF) is a financial apex body formed in 2010 through the efforts of a consortium of stakeholders led by ZAMFI, HIVOS, DFID, DANIDA and GIZ with the objective of providing wholesale lending capital to Financial Service Providers (FSPs) such as Microfinance Institutions (MFIs), Banks and Savings and Credit Unions (SACCOS) and Value Chain Actors (VCA), for retailing to micro and small enterprises (MSEs) in Zimbabwe (ZMF Operations Manual, 2015). ZMF's head office and only office is located in Harare.

## **1.2 Statement of the problem**

As highlighted above, granting credit is an objective of MFI's, stringent policies as compared to lenient policies yield high loan performance. As is the case with Zimbabwe Microfinance Fund, there is need to revisit the credit policy and craft a stringent one so as to deal with the issue of Nonperforming loans that has saddled the institution.

## **1.3 Objectives**

The following research objectives have been developed to obtain requisite demands of the research problem:

- i. To analyse credit risk management on credit policies.
- ii. To evaluate the credit risk management practices of ZMF.
- iii. To assess the implications of nonperforming loans to the microfinance sector.
- iv. To recommend on how credit risk management practices can be enhanced as a strategy to bring down the level of nonperforming loans.

#### **1.4 Main research question**

What is the effect that credit risk management of Microfinance Institutions has on the level of nonperforming loans?

##### **1.4.1 Sub research questions**

- i. What is the bearing of credit risk management on non-performing loans?
- ii. What constitutes ZMF's credit risk management policy?
- iii. How can credit risk management policies be effectively developed to curb the problem of nonperforming loans?
- iv. What other factors are contributing to an upsurge of non-performing loans?

#### **1.6 Significance of the study**

This study will therefore be relevant in assisting ZMF and the microfinance sector identify credit policy gaps in an endeavor to put in place robust credit management systems to maximize on collections , bringing down the level of non-performing loans. The study is also further intended at enriching the researcher academically and in practical sense.

#### **1.7 Delimitations**

- The research is concentrated on MFIs around Zimbabwe though special attention will be on ZMF located in the central business district of Harare.
- There are various other external factors which contribute to an upsurge of NPLs. The study will dwell only on credit risk management as an internal factor which can be controlled by the institutions.
- The study will cover the period 2012-2017

#### **1.8 Limitations**

- Confidentiality- The management and staff might not be at liberty with disclosing some information they feel is detriment to the company but is of essence to the research. To mitigate the effects, several respondents from the institution will be interviewed to produce different views of the challenges they are facing so as to have a broader objective picture.

- Some respondents may fail to return questionnaires on time for analysis and this will reduce questionnaire response rate, to curb this, vigorous follow up will be undertaken to get questionnaires on time.
- Desk research – the researcher is going to rely mainly on desk research data, to this extent, a questionnaire and interview survey will be conducted on a carefully chosen panel of respondents so that quality of possible outcomes will be enhanced.

### **1.9 Research assumptions**

The research will be carried out on the assumption that credit risk is the only factor giving birth to non-performing loans witnessed by MFIs.

### **1.10 Definition of terms**

- Micro finance involves the provision of financial services that aim to improve and protect the livelihoods of active economic agents who have limited access or are denied access to normal financial services as provided by banks and other formal financial sector institutions because of the small nature of their operations, geographical location, limited sources, and volumes of their income base.
- Credit risk is the financial exposure resulting from a microfinance institution's dependence on another party (counterparty) to perform an obligation as agreed.
- Risk managements the process of managing the probability or the severity of the adverse event to an acceptable range or within limits set by the MFI.
- A non-performing loan is when the payment of interest and principal are past due over 90 days.
- 

### **Acronyms**

- NPL Nonperforming loan
- PAR Portfolio at risk
- ZMF Zimbabwe Microfinance Fund
- RBZ Reserve Bank of Zimbabwe
- MFI Microfinance Institution
- CRM Credit Risk Management

- FSPs Financial Service Providers

### **Chapter summary**

This chapter has given a brief background of the research topic. General information and relationship between credit risk management and nonperforming loans has been discussed linking this to the problem statement. The objectives guiding the study are also given. The chapter concludes highlighting the relevance of the study and the definitions of terms that have been used in this chapter. The next chapter aims to review literature that discusses credit risk management and non-performing loans in detail showing the correlation between the two.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter presents the literature review, indicating variables and relationships relevant to the proposed study. It also discusses the empirical review where research work by other researchers and authors in the field under study is discussed, focusing on the objectives of this research as mentioned in chapter 1. A chapter summary is then given at the end of this section.

#### **2.1 Theoretical Review**

##### **2.1.1 Information Asymmetry Theory**

Galindo and Micco (2010) allude that credit risk and default rates can be attenuated through information sharing by lenders as it is an aid for financiers to improve credit risk assessment. The seminal work of Akerlof (1970) and Stiglitz (1976) led to the origination of the theory of asymmetric information, which results from one party having insufficient knowledge about the other party to make accurate decisions (Tumay, 2009). Furthermore, Tumay mentions that knowledge of payment history, total debt exposure and overall creditworthiness disseminated through information sharing bridges the information divide between lenders and borrowers and is an important credit risk management practice.

Nguyen 2017 recognizes information asymmetry as an in-balance between two negotiating parties in their knowledge of relevant factors and details. Information asymmetry in the credit market turns out to be more apparent and its effects crucial in those situations where an institution is less aware of the borrower's real payment ability due to risks assumed in financing a project (Barbosa & Marcal, 2011). In borrowing, asymmetric information challenges stem from the fact that a lender's knowledge of a borrower's possibility of repaying (risk profile) is imprecise and must be induced in view of available information (Turner & Varghese, 2010).

Information asymmetry can be resolved directly through appraisal which entails a sophisticated credit risk policy which will provide institutions with risk protection or indirectly through screening, signaling, or contingent payments (Turner & Varghese, 2010). Moreover, adopting



Information sharing as part of the organizational culture allows a lender to better assess the risk profile of a potential borrower and prompt timely payments as inability to pay will result in inability to access credit from other institutions

## **2.2 Concept of Credit Risk Management**

Mwengei (2013) defines credit risk management as a process and a comprehensive system that begins with identifying the lending markets and proceeds through a progression of stages to loan repayment. Mwisho 2011 mentions that the way in which an institution manages its credit risk has an implication on the overall financial performance and survival of that specific organization. Furthermore, Klein (2013) elaborates that credit risk management is a dire component of a comprehensive approach to risk management underpinned by an effective board and senior management oversight, well defined policies and procedures, strong management information systems and adequate internal control systems. It can be said that the establishment of sound and well defined policies, procedures and limits is vital in the management of credit risk and that these policies and procedures need to be well documented, duly approved by the board and strictly implemented by senior management.

Moreover, Klein (2013) asserts that credit policies should address such topics as target markets, cost and non-value terms, the structure of limits, approval authorities and exception reporting and must be defined clearly, be consistent with prudent lending practises and pertinent administrative prerequisites. Furthermore, Klein elaborates that laws and regulations provide safeguards from systematic risk for the entire industry were as sophisticated credit risk policies, strategies, and tools provide institutions with risk protections.

Practices of credit risk management in financial institutions involve minimization of risk exposures and occurrence of loans losses as alluded by Malhotra (2011). Mwengei (2013) highlights that credit risk management can be viewed as the identification, analysis and assessment, monitoring and control of credit having direct effects on the amount of loans and advances extended to clients as well as on the level of nonperforming loans.

The board and management of an organization is mandated in setting up procedures and policies which should address parameters for composition and spread of credit portfolio covering four aspects of management oversight, policies, internal controls and measurement for effective credit risk management (Central MFIs Annual Report, 2014).

### **2.2.1 Credit Policies**

A credit policy is a set of guidelines used by an entity to outline terms and conditions applied in offering credit, define single obligator limits and outline limits on outstanding accounts as well as the steps and procedures used to deal with delinquent clients (Maysami, 2010). Furthermore, credit policies are an encapsulation of risk aversion within an entity and should be in line with the organizations business plan. As alluded by Klein 2013, the board of directors should determine the institutions credit criteria to be applied, determine those responsible for checking prospective and existing client's credit worthiness and formation of a credit committee that will be responsible for authorizing all credit transactions and oversee the institutions lending processes. The credit committee will have the mandate to ensure that overall risk management is aligned and adhered to across the operations of the entity (Klein, 2013). Moreover, the credit committee stands to act on recommendations made by executives, fore-instance on issues to do with new lending products, channels and markets credit risk management.

Credit policies should be clearly articulated as they help govern the lending activities of an entity (Mirach, 2010). The significance can be evidenced in operational efficiency of lending departments as it reduces ambiguity over how they should proceed with their daily functions (Bullivant, 2014). Furthermore, credit policies help improve an organizations cash flows as they set the tone on accounts receivable turnover.

A credit policy should entail components explaining products offered, target clients, eligibility criteria, interest rates and loan repayments and loan approval threshold as highlighted by Mirach 2010. A brief explanation of what the highlighted components refer to is outlined below:

- i. Credit products: The entity should describe its products on offer that will be available to the client and highlight the terms, conditions and obligations that the client needs to meet for them to tap into the institutions products (Mirach, 2010). As an example of an
- ii. obligation, it can be highlighted that clients to be funded should be compliant with environmental and social impact concerns as put up in government and the developmental partner's policy documents.
- iii. Target clients- Embedded in the policy should be the list of targeted clients by the institution and state which clients shall not be eligible (Mirach, 2010). For instance ZMF being a wholesale facility, its focus covers the range of Banks, Deposit taking MFIs, Credit Only MFIs, Non-Financial Institutions e.g. contract farming companies and clearly states that it shall not lend to partners that lend to MSEs that engage in activities that impact negatively on the environment without implicating mitigation measures as well as activities that result in human rights abuse (Operations Manual, 2015).
- iv. Eligibility criteria- The policy should also contain minimum conditions that all applicants should satisfy in order for an applicant to tap into the institutions products.
- v. Interest and loan repayment- The policy should highlight the interest rates to be charged on products offered on credit as instituted by the Microfinance Act ( Chapter 24:29). The RBZ being the regulator of Microfinance Institutions put a cap on interest rates to a maximum of 10% all-inclusive rate per month therefore the policies should be in line with the directive. Furthermore, the Act stipulates that the credit policy shall state therein the guidelines for repayments.

### **2.3 Nonperforming loans and loan performance**

Nonperforming loans are loans that have defaulted or are in danger of defaulting as payments are no longer being made (Warue, 2013). The RBZ (2016) in its monetary policy of 2016, highlighted that nonperforming loans (NPLs) are a hindrance to economic stability and growth of economies. Moreover the RBZ is cognizant that the problem of high levels of NPLs which exceed the international benchmark of up to 5% can be a

threat to financial stability and economic growth and as such, it points out that addressing the problem of NPLs is essential in order to invigorate the Zimbabwean economy.

### **2.3.1 Loan portfolio performance**

Philip (2011) defines loan portfolio as the aggregate sum of money offered out to borrowers by an MFI at any given point in time. He further defines loan portfolio performance as rate of

profitability or return on an investment in various loan products. In more extensive terms, Philip alludes to portfolio performance as a number of microfinance clients accessing loans, how much they are borrowing, timely repayments of instalments, security pledged against loans and rate of recovery of loans in arrears. Moreover, the stated author asserts that portfolio performance relates to management of the risk of loan delinquency and determines future revenue generation and an institution's ability to increase its outreach and serve existing clients.

Warue (2012) identifies loan delinquency as a key component of portfolio performance which he says comprise three factors namely loan collection rate, arrears rate and PaR while Kar and Swain (2014) identifies four components being, arrears rate, write off ratio, risk coverage ratio and PaR. They concur that the widely accepted portfolio performance indicator by MFIs is PaR. PaR represents the portion of the loan portfolio that is contaminated by arrears hence putting it at risk of not being repaid (Rosenberg et al, 2013).

### **2.3.2 Loan Classification**

There are ways of classifying loans which helps financial institutions to evaluate loan facilities to enable them to grant credit based on observed risk and other features of the particular loan class (Moti et al, 2012). Furthermore, the author mentions that classification also makes it possible for financial institutions to monitor the quality of their loan portfolios and enable them to take corrective action so as to counter decline in quality of their loan portfolios. Loans advanced by MFIs are classified into categories in order to determine the level of provisions to be made in conformity with regulations stated in the Microfinance Act Number 3 of 2013. ZMF has its loans classified into 5 categories as highlighted by its Operational manual being:-

- i. Normal Credit Risk (Pass)-These are loans that are performing in accordance to the contractual terms and are less than 30 days past due.
- ii. Watch (Special Mention) - These are loans in which the principal or the interest is due and remains unpaid for 31 – 90days.
- iii. Substandard- These are loans in which the principal or interest is due and remains unpaid for 91-180 days.
- iv. Doubtful- This is a credit facility in which the principal or the interest due and remains unpaid for 181-365 days.
- v. Loss- This is a credit facility in which the principal and the interest is due and remains unpaid for over 365days.

### **2.3.3 Internal factors contributing to nonperforming loans**

High interest rates have been noted as a factor contributing to high levels of nonperforming loans by the RBZ (2014) in its first quarter industry report. The Microfinance Act Number 3 of 2013( Chapter 24:29) requires the display of information relating to interest rates and other charges on loan advances and in line with that requirement the Smart Campaign (2011) in a quest to protect the interest of microfinance clients called for transparency in calculation of interest charges. Hudon (2009) and Ekanayake et al (2015) established that the higher the interest rates the more the inability of borrowers to repay the borrowed funds resulting in nonperforming loans.

Moreover issuance of loans basing on projections instead of capacity to repay is another factor resulting in nonperforming loans (Greenidge & Grosvenor, 2010). Loan sizes and terms can make repayment difficult implying that the lender should critical analyse the borrower's ability to pay and offer a loan amount that the borrower is able to pay back not rather focusing on financial projects that the borrowers is targeting to achieve as per the business plan. Furthermore, Nyamutowa & Masunda (2013) also highlight that lending basing on collateral rather than capacity has led to nonperforming loans as the effect results in poor asset quality that in turn increases an institutions exposure.

Munene & Guyo ( 2013) have attributed non performing loans to imprudent lending strategies adopted by financial institutions in particular insider lending which refers to advancing loans of a financial institution to its officers. Prudent lending would imply issuing such loans at the same interest rate, repayment terms and credit evaluation as applies to external borrowers.

Poor management is another factor leading to non-performing loans as highlighted by Ekanakaye et al, 2015. The above author elaborates that management at times do not practise adequate loan underwriting, monitoring and control. As it implies weak monitoring controls for both operating costs and credit quality, the effect will induce high levels of capital losses. Furthermore, Risk management being a continuous process of identifying risks that are sometimes subject to quick and volatile changes, not implying good credit risk management practises is a cause for nonperforming loans through aiding unacceptable exposures for the institution.

#### **2.3.4 Effects of NPLs on Microfinance Institutions and Zimbabwean Economy**

The interest income generated from loans contribute significantly to the profitability performance of the microfinance institutions, however, when loans become delinquent, it has a serious negative effect on the health and operations of the MFI .One of the reasons is that, in line with International Accounting Standards (IAS) 39, the lending institution has to make a provision and charge for credit losses (bad debt/impairment) which ultimately reduce the profit level.

Furthermore, nonperforming loan portfolio tends to undermine the Microfinance Institutions ability to grant more credit. This is because the loanable funds tend to deplete when repayment of loans delay or are eventually not paid (Rose & Hudgins, 2011). Moreover, nonperforming loans which are sometimes described as “toxic asset”, result in loss of confidence on the part of investors leading to liquidity challenges.

Moreover, as a result of nonperforming loans, a financial institutions continued operations are at risk and financial institutions face threats of closure (Nyamutowa & Masunda, 2013). In the Zimbabwean context we have institutions like Collective Financial Services, Virgin

Microfinance and First Choice Microfinance among others that succumbed to nonperforming loans and eventually ceased operating.

Apart from being a source of concern for financial stability, there is strong evidence that NPLs have led to a decrease in credit growth which undermine economic recovery efforts (RBZ, 2014). The situation in which institutions are saddled with high NPLs for a long period would result in the prolonged stagnation of the economy. The problem of non-performing loans has a mechanism to drag on the economy in a number of ways including the following, as highlighted by the RBZ:

a) Lowering an institutions intermediary function due to erosion of profits;

As financial institutions play a crucial role of allocating and distributing savings in most productive investments, this intermediary function is critical as it enhances productivity and efficiency of an economy. As nonperforming loans continue to exceed institutions profits, the institutions net worth is reduced thereby lowering their risk taking capacity making it impossible to fund risky projects and realize potentially productive businesses (Chimkomo, 2016).

b) Deterioration of entity assets and erosion of their capital;

Since an entity would not be earning interest income on NPLs, these bad assets deny the institution interest income that would had been received through performing loans and also entail missed opportunities of investing in some return earning investments which in turn affects their streams of profits (Chimkono, 2016)

c) Stagnation of economic resources, such as labor and capital, in areas with low productivity; and

d) Decline in lending, as institutions with high level of non-performing loans in their portfolio may become increasingly reluctant to take up new risks and commit new loans; and pose serious challenges to the pursuit of macroeconomic stability and growth objectives by government.

#### **2.4 Relationship between Credit risk management and Nonperforming loans**

Loan loss is a prevalent sort of risk that financial institutions must manage, which comes to fore when a borrower neglects to satisfy their commitment to pay back the loan to the lender and

affects the financial institutions liquidity (Greuning and Bratanovic, 2009). Subsequently credit risk management practices includes practices to minimize risk exposure and occurrence of bad debts and with a greater position of lending institutions balance sheet relating to the aspect of risk management, credit risk management is crucial to any financial institutions success.

CRM refers to identification, analysis and assessment, monitoring and control of credit which has direct implications on the amount of loans and advances extended to customers as well as on the level of nonperforming loans (Ahamed and Malik. 2015). Moreover, the credit amount measured by loans offered to clients and loan losses are used as proxies for credit risk and for successful loan loss management, it is required that approaches and systems which at least address the spread of credit portfolio be established. According to Checkley and Dickinson (2010), borrowers ought to be subjected to stringent CRMP, this will enable the analyzation of the borrowers character, capacity to repay, reason for the loan stressing on viability, repayments and insurance to caution risk defaulting on the loan highlighting the inverse relationship between nonperforming loans and credit risk management.

#### **2.4.1 Mechanisms of Reducing Credit Risk-Non Performing Loans Monitoring and control**

The occurrence of bad debts can be reduced if lenders pay attention to monitoring and control (Rouse 2009). In monitoring and control Rouse identified internal records, visits and interviews, reviewing audited accounts and management accounts as some of the ways that help in the monitoring and control process. Furthermore, this can minimize the occurrence of non-performing loans through ensuring the utilization of the loan for the agreed purpose, identifying early warning signals of any problem relating to the operations of the customer's business that are likely to affect the performance of the facility enabling the lender to discuss the prospects and problems of the borrower's business. Through the monitoring and control process, a lending decision can be made on sound credit risk appraisal and assessment of creditworthiness of borrowers.



## **Credit Appraisal**

This includes loan request procedures and requirements contained in the credit policy documents of credit issuers to guide loan officers in the processing of loans for customers and is one of the crucial stages in the loan processing procedures because this stage analyses information about the financial strength and creditworthiness of the customer (Rose, 2010). The factors considered in granting loans include; applicant's background, the purpose of the request, the amount of credit required, the amount and source of borrower's contribution, repayment terms of the borrower, security proposed by the borrower, location of the business or project and technical and financial soundness of the credit proposal (Haneef et al., 2012).

## **Policy and Objectives**

Clear policy has to be communicated well among the staff and clients with proper signals. Without clear policy, communicated objectives may not be set clearly or not taken seriously. Unclear objectives on loan collection, for example, may result in low quality of loan portfolios (Klein, 2013).

## **Credit Information Sharing**

Information asymmetry alluded to earlier on can be resolved by adopting information sharing as part of an organizations culture. Pagano and Jappelli (2013) show that information sharing reduces adverse selection by improving institutions information on credit applicants, highlighting the need for a centralized credit bureau. Financial institutions in Zimbabwe including Zimbabwe Microfinance Fund are generally exposed to heightened credit risk owing to high levels of information asymmetry and the lack of a credit information sharing mechanism. Cognizant of these challenges the Reserve Bank is working on bridging the information asymmetry gap in the financial sector through establishing a central credit registry system within its structures.

## **Management Information Systems**

Management information systems are essential for accurate data and monitoring of customers progress and there should be effective management information systems in tracking payments, due loans, and overdue loans in order to systematically monitor loan performance (Phillip, 2011).

ZMF currently using Loan Performer Version 8 stems to be inefficient as there are challenges with the system, as it fails to meet the demands of the organization.

## **2.5 Empirical Evidence**

Mwithi (2013) conducted a study to determine the relationship between credit risk management practices and the level of non-performing loans of microfinance institutions in Nyeri County, Kenya. It was discovered that effective management of NPLs in MFIs in that area were affected by liquidity and profitability, and asymmetric information in loan markets. The study also highlighted that inability to enforce covenants lead to NPLs among MFIs in Nyeri County significantly. The study concluded that the relationship between credit risk management approaches employed by MFIs in Nyeri County and the level of NPLs was a negative correlation i.e. the higher the level of credit risk management, the lower the level of NPLs.

Furthermore, Haneef et al (2012) conducted a study to investigate the impact of risk management on non- performing loans and profitability of the banking sector of Pakistan. The results of the study reveal that there is no proper mechanism for risk management in the banking sector of Pakistan. The study also concluded that non-performing loans are increasing due to lack of risk management which threatens the profitability of banks. They further elaborated that risk management encompasses risk identification, assessment, measurement, monitoring and controlling all risks inherent in the business of banking.

Moreover, Biabani et al (2012) conducted a study on the assessment of effective factors on non-performing loans (NPLs) creation on the banking sector in Iran. Results from the empirical analysis highlighted that lax credit risk management practices were a key factor giving birth to NPLs therefore the need for banks to come up with measures, policies and procedures for preventing NPLs and impact on a sound financial sector.

Sandada & Kanhuwe (2016) conducted a study to analyse the factors leading to rising credit risk in the Zimbabwean banking sector and highlighted that, the factors were macroeconomic and bank specific factors. They further alluded that, the interrelatedness of economy performance and credit risk points out the importance for the policy makers to address the fundamentals of the economy. Moreover, credit risk is a phenomenon that affects all credit granting organisations and this includes non-banking financial institutions and encourage that study should be extended to these other credit granting organisations as study has been concentrated on banks.

According to Nyamutowa & Masunda (2013), they allude that credit risk has presented challenges to bank management since the day they started engaging in lending activities and is the major cause of financial crisis. Furthermore, they mention that credit risk models are not engaged with equal rapidity in banks as the difficulty shoots from unavailability of suitable quality data for input which strikes on those outstanding balances at the time of default are unknown in advance.

Mavhiki et al (2012) conducted a study to analyse the challenges being encountered by banks in managing credit in Zimbabwe and to establish the connexion between lending decisions and the level of exposure. The study revealed that increased lending by banks exposes them to high risk of failure. They also found that the level of nonperforming loans was increasing, signalling that banks' exposure levels are rising and are likely to encounter difficulties due to deterioration in their loan qualities. As a recommendation, they suggest that banks introduce sound credit risk management systems with policies and guidelines outlining the range and allocation of credit to enable effectively screening borrowers to mitigate high default rates

## **2.6 GAP SUMMARY**

Studies undertaken in the past years have confirmed that there is a negative relationship between credit risk management and nonperforming loans in financial institutions with most studies on banks. Having been identified that a relationship exists between the two variables, the question now becomes how credit policies can be further improved in order to deal with the issues on nonperforming loans as an institutional specific factor that institutions have control over.

Furthermore, no studies have been carried out to answer how credit policies can be further improved. Suggestions have only been made on MFIs to adopt stringent policies as a method of collecting loans as compared to lenient policies given the reason that stringent policies yields high loan performance (Warue,2012). This study seeks to fill the gap on credit policy improvement, reviewing the credit policies implemented by the case in study ZMF.

## **2.7 Chapter Summary**

This chapter reviewed the existing literatures related to the research problem and was subdivided into headings: Theoretical review, Concept of risk management, Loan performance and nonperforming loans in MFIs, Implications of NPLs to the MFIs and the Zimbabwean economy and also reviewed empirical findings by other scholars. From the review of the literature, a gap summary was developed to summarize the comprehension of the problem by the author. The next chapter will outline the techniques used in carrying out the study

## **CHAPTER 3**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

This chapter outlines the tools and methods employed to gather data that will be used in analyzing credit risk management practices employed by Zimbabwe Microfinance Fund and the structure and contents of their credit risk management policy in light of bringing down the level of nonperforming loans. The areas elaborated are the research design, subjects, research instruments and the sources of data. Furthermore, justifications will be made to how the tools and methods employed fit to the study and a chapter summary given at the end.

#### **3.1 Research Design**

The research design refers to a plan used to assimilate different constituents of a study in a lucid way to ensure that the research problem is effectively addressed (Burch & Carolyn, 2016). This study employed a descriptive research design which helped in gaining valuable information on the particular problem under research and to be able to describe characteristics of the variables in this situation.

According to Johnson (2013) descriptive research refers to a conjectural method that establishes an observation and describes the behavior of a particular subject. Saunders et al (2009), mentions that it helps afford answers to the problems of what, when, where, and how associated with a specific research problem. Moreover, it is applied to obtain data concerning the present status of the events, describing what “currently is” regarding variables in a situation (Labaree, 2015). It can therefore be said that the design is concerned with situations, practices, existing relationships and evident trends which makes it suitable for this research. Moreover, it will enable an in-depth analysis of the problem of nonperforming loans in microfinance institutions in-relation to credit risk management pointing out prevailing credit risk management practices at ZMF, ongoing processes and effects that are being felt.

### **3.1.1 Research Approach**

A mixed research approach was adopted in carrying out this research. As defined by Venkatesh et al (2016), it is a framework for conducting a research that defines the collection, analysis and integration of both the qualitative and quantitative data in a single research. Furthermore, Dulock (2010) alludes that the mixed approach provides a more comprehensive picture of the research from the way observations are linked with statistical analysis. Moreover, it offsets the disadvantages of using either the quantitative approach or the qualitative approach in isolation.

Since the study is based on an existent relationship between credit risk management and nonperforming loans, adopting the mixed approach helped encompass the attainment of in-depth knowledge regarding the problem issue and bringing to fore past experiences that enabled the researcher to evaluate credit risk management practises employed by ZMF resulting in the fulfilment of the research objectives. In-depth detail is unachievable when a quantitative approach is used in isolation as it ignores other qualitative factors. Therefore, as this approach overshadows the disadvantages of making use of one approach in isolation of the other, the mixed approach was deemed appropriate for this study.

## **3.2 Subjects**

### **3.2.1 Target Population**

Barerjee & Chaudhury (2010) together with Wienclaw (2015) express a population as a totality of elements, possessing common characteristics that meet the selection criteria for a study to be carried out and from which a sample is drawn.

The targeted population of this study was 14 staff members consisting of loan officers, finance officers, monitoring and evaluation officers and managers of ZMF, which is the case entity under study. The targeted population was on the basis of possessing appropriate knowledge and experience regarding credit risk management practices within the organization to ensure collection of reliable and accurate information, motivated by the rational that information on credit risk management is specific.

### **3.2.2 Sampling**

Sampling is a method of selecting an appropriate representative fraction of a population with the idea of shaping parameters or features of the entire population (Sanders et al, 2012). The sample selected constituted of 3 Finance Officers, 1 Operations Manager, 3 Loan officers and 1 Monitoring and evaluations officer. The sample was preferred because of its involvement in credit risk management at ZMF and in the absence of a risk officer within the institution the above have a role to play in risk governance and therefore were in a better position to comment from a knowledgeable point of view on the subject matter.

### **3.2.3 Sampling Method**

According to Aaker (2012), sampling methods can either be probability or non probability methods. This study adopted the use of a judgmental sampling technique. Malhotra (2011) explains that judgmental sampling is a technique that makes use of the researcher's personal judgement rather than making use of chance selection. The choice of this technique was motivated by the fact that information on credit risk management strategies and nonperforming loans is specific and therefore those charged with monitoring and governance of the variables possess the requisite knowledge which led to the technique being adopted in order to obtain reliable data.

## **3.3 Research Instruments**

### **3.3.1 Likert scale**

Johnson & Wislar (2014) believe that the perceptions of the population in a research are easily measured using a survey instrument with a Likert scale. A Likert scale is a psychometric scale commonly involved in research that employs questionnaires that ask respondents to select a rating on a scale that ranges from one extreme to another, such as strongly agree to strongly disagree (Bryman, 2014). The Likert scale was adopted in crafting questionnaires that were used to administer data at ZMF. It is advantageous as it is easy to use as respondents are merely asked to choose from a list of responses as alluded by Suresh (2015). Furthermore it is convenient as it acknowledges the quality of feeling which helps in data analysis.

**Table 3.1 Likert Scale**

<b>Attitude</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
Points	5	4	3	2	1

Source: Creswell, (2012)

Table 3.1 shows the five different predetermined categories of respondent’s decisions and their respective assigned value.

### **3.3.2 Questionnaire**

A questionnaire defines questions to be asked, the potential answer, the order in which the questions must be asked and the conditions under which the questions have been asked(Bryman, 2014). Furthermore, Valiant et al (2015) expresses a questionnaire to be a sequence of questions asked to individuals to acquire statistically useful information about a given topic.Data was solicited using a questionnaire as the primary source in this study in obtaining neutral opinions of respondents .The questionnaire was prepared basing on the objectives of the study and made use of closed ended questions which had a Likert scale and a few open ended questions.Closed ended questions leave an information gap on the side of the respondent as their ideas fail to be effectively expressed (Griffin, 2013) and as such this became the motivation behind including open ended questions to the questionnaire and supplementing questionnaires with an interview.In addition, the researcher used open ended questions as they were designed to determine what people know, what they think or how they act (Griffin, 2013).Specimen of the questionnaire is attached as appendix 1.

### **3.3.3 Interviews**

The researcher used a self-deigned interview guide as a supporting data instrument to seek information from the respondents. Bryman (2014) states that an interview is suitable for a small sample size, and in this study only 5 respondents will be interviewed. The research used face to face interviews to obtain information relating to the research questions. The interviews conducted in this research were oral interviews.To reduce the risk of having mixed information, the researcher made use of an interview guide and also made sure that the responses were captured to avoid loss of data or missing important information. The researcher chose interviews because the interviewer can investigate deeper into a response given by the interviewee.



Furthermore, interviews helped to seek clarifications on factors such as techniques used to mitigate risks, components of an effective credit risk management system among other factors. The

### **3.4 Sources of Data**

Both primary and secondary data were utilized as part of this study.

#### **3.4.1 Primary sources**

Primary data refers to data that is gathered directly from respondents and is more reliable as a result of it being collected from concerned parties (Blosch et al, 2010). Primary data was collected through the use of questionnaires and interviews. In light of the fact that questionnaires provide an efficient and effective way of collecting data within a short time period and assist in easier coding and analysis of data, supported the use of questionnaires in this study. An advantage of primary data is that it is specifically tailored to the research needs.

#### **3.4.2 Secondary Data**

Secondary data, refers to the collection of data formerly gathered for another purpose (Saunders and Cornett, 2011). The researcher made use of information from published journals mainly so as to acquire reliable information and also made use of the risk and operations manuals of ZMF. Secondary data was used to support primary data. Secondary data was used to collect information prior to the research being undertaken which assisted in the formulation of objectives as well as after commencement of the study. Arthur and Koziol (2010), outlined that secondary data is mainly used before data collection and helps the researcher in explaining the research questions and the formulation of objectives.

The use of secondary data was beneficial firstly in that this was less expensive in terms of time and money (Denscombe, 2010). Denscombe expresses that the internet era simplified data collection processes as precise information can be accessed through search engines as opposed to follow ups on various books in the library which consumed more time.

Moreover, it can lead to unearthing of new discoveries and also enable the generation of insights from past studies conducted as alluded by Fabregas (2013). However on the other hand, there is inappropriateness of data in the sense that data collected by oneself is meant to meet some objectives and in this sense secondary data would provide vast information which would have

been collected to meet different objectives delimiting its appropriateness as alluded by Denscombe (2010).

### **3.5 Data Presentation and Analysis**

#### **3.5.1 Data Presentation**

The data was presented in the form of analytical tables as well as through the use of charts. According to Chiromo (2009), after data has been gathered, it has to be presented in a visually appealing fashion without sacrificing the richness of the data and should be presented in a way that will impart the maximum information in the most proficient way.

#### **3.5.2 Data Analysis**

The data obtained from the questionnaires and interviews is coded by going through all the questions with a view to establishing common themes, patterns and relationships. Data collection involves choosing what and which significance can be ascribed to the words and what are the suggestions to that impact and how can it identify with the theme under scrutiny (Almer, 2013).

### **3.6 Chapter Summary**

This chapter highlighted techniques and methodologies adopted in conducting this study. Descriptive research design, mixed approach and judgmental sampling technique were adopted in this research. Moreover, primary and secondary data sources were used in the study. The following chapter will cover the data presentation, analysis and interpretation.

## CHAPTER 4

### DATA PRESENTATION AND ANALYSIS

#### 4.0 Introduction

This chapter presents findings obtained from the case company ZMF on the study of credit risk management on nonperforming loans. Questionnaires were used as the primary source of data and were complimented by interviews. These instruments sought to answer the research questions against the objectives of this study. Presentation of data was through the use of charts, graphs and tables though in some instances only descriptive digests were given.

#### 4.1 Response rate

This study had a sample size of 8 individuals working at Zimbabwe Microfinance Fund .The researcher distributed 8 questionnaires of which all 8 questionnaires were received back. The 100% response rate indicates a satisfactory representation of the entire staff such that conclusions from the findings obtained can be relied on.

**Table 4.1 Response rate on interviews and questionnaires**

	Distribution	Response	Response Rate
Interviews	4	4	100%
Questionnaires	8	8	100%

Source Primary data

#### 4.2 Presentation and analysis of data from questionnaires

##### 4.2.1 Background Information

The study sought to point out information with regards to the respondent's level of education attained, gender and term of service with the company, with the aim to test the suitability of the chosen respondents in answering the listed questions in the questionnaires.

**i. Respondents gender**

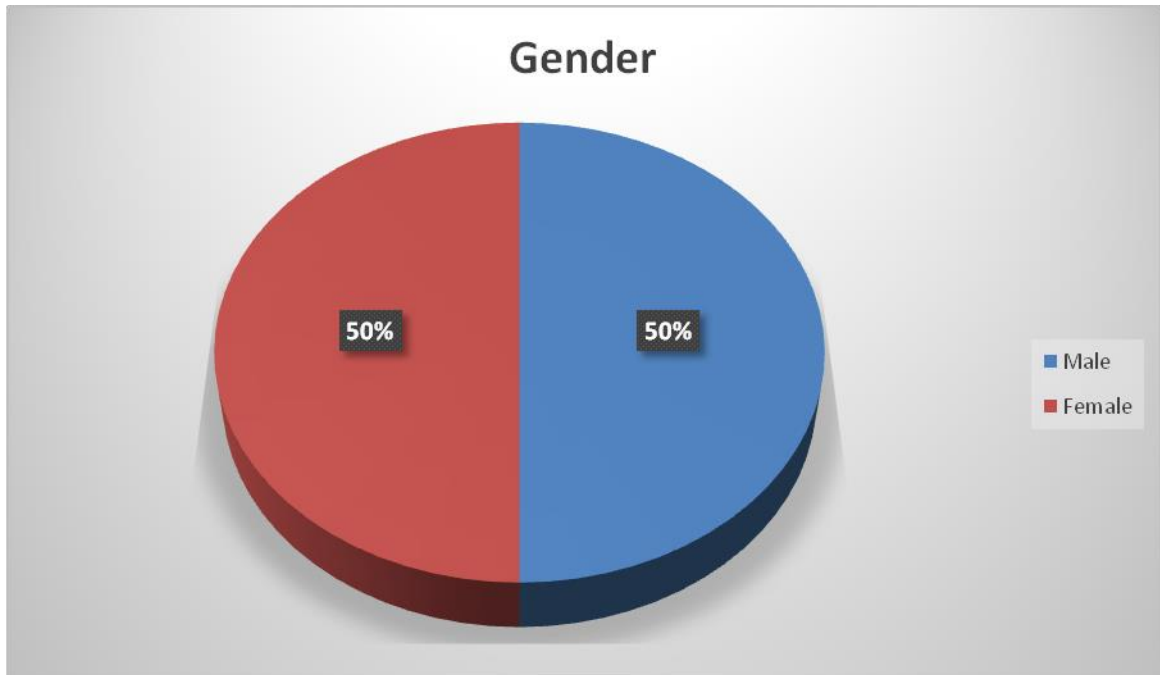


Fig 4.1

From the findings highlighted by fig 4.1, the sample had an equal representation between male and female respondents. The essence of highlighting the gender of respondents was to ensure that there was a representation of both sexes in the study.

**ii. Academic level attained**

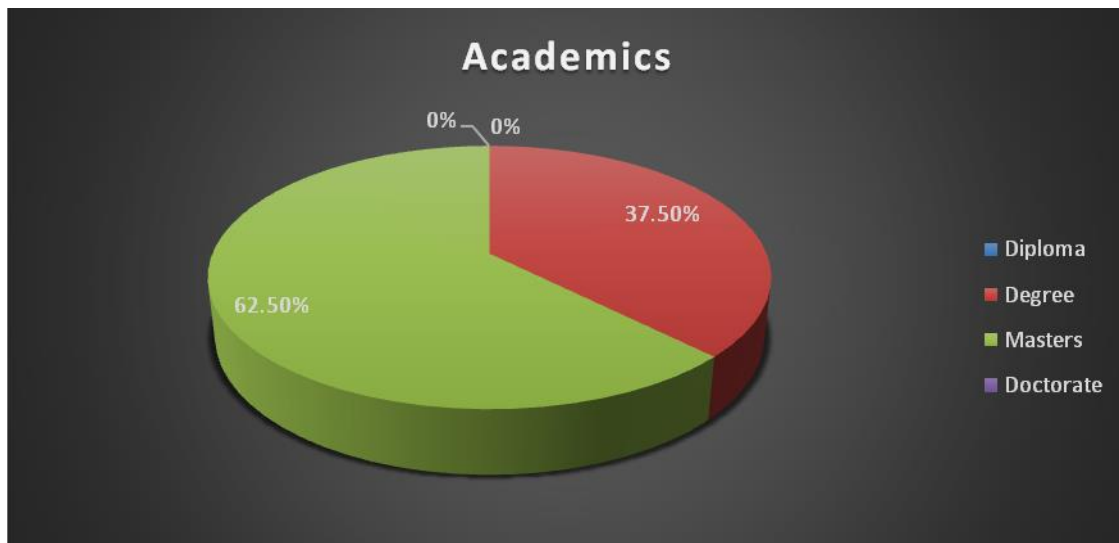


Fig 4.2

Fig 4.2 exhibits the qualifications attained by the respondents employed in this study. The majority of the respondents constituting 62.5% are holders of a master's degree, were as 37.5% of the respondents are degree holders. None of the respondents hold either a diploma or a doctorate. This is insignia of the respondent's suitability to rely on their responses basing on their knowledge.

**iii. Term of service**

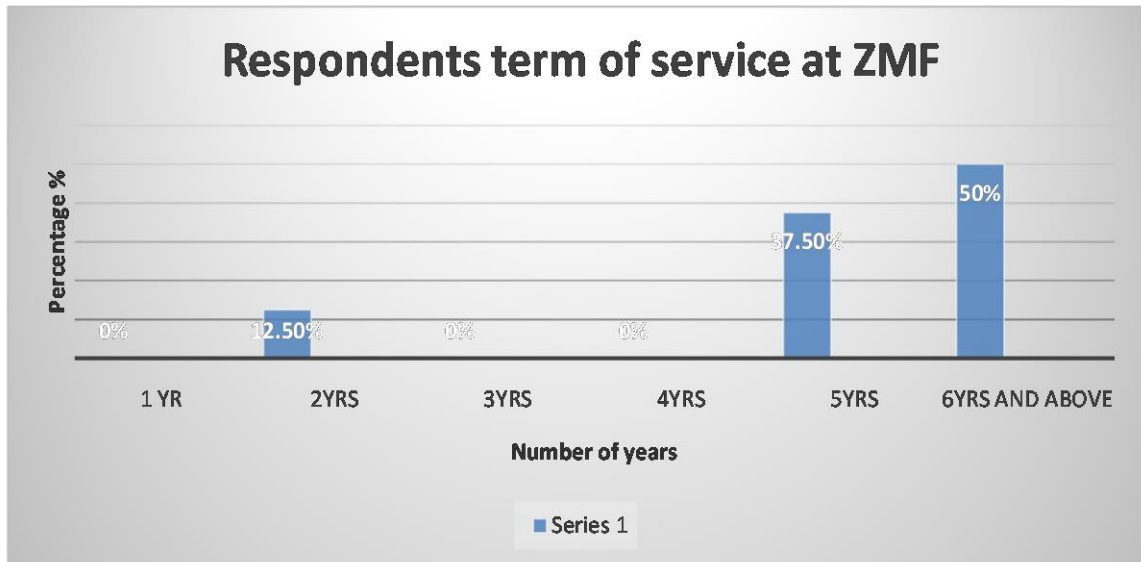


Fig 4.3

From the figure exhibited above, 50% of the respondents have been with the organization since inception in 2010, followed by a 37.5% of the respondents having had worked for the organization for 5 years and 12.5% of the total respondents having had been working for the organization for a period of 2 years in length. The significance of incorporating the length of service was to ensure that information is adapted from those individuals who have an understanding of the operations, procedures and policies of the organization.

**4.2.2 Credit Risk Management policies analysis**

Fig 4.4 below exhibits responses provided by respondents on policies strengths and availability of clearly articulated credit policy documents at ZMF.

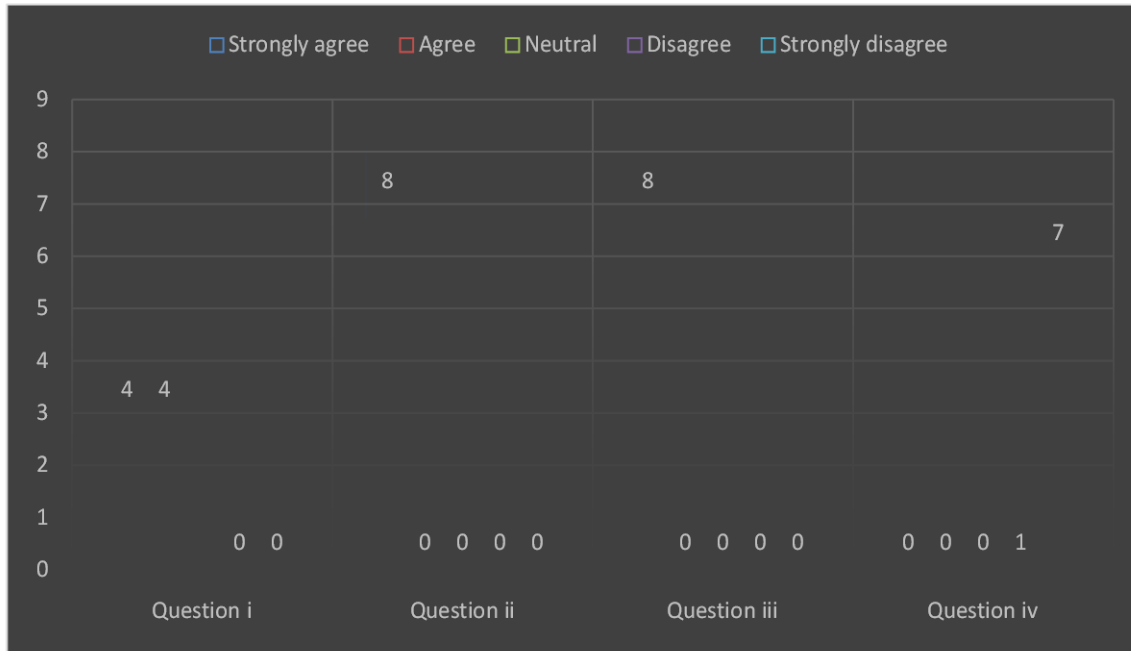


Fig 4.4

From the bracket labelled Question i, the question posed was whether ZMF had a well-documented credit risk management policy. All respondents are of the view that ZMF indeed has a well-documented credit policy. It follows to say that the institution is cognizant of the essence of having a clearly articulated credit policy. Mirach (2010) stated that credit policies should be well articulated as they help in managing lending activities of an entity standing in support of the finding obtained. Furthermore, the bracket Question ii required a response on whether the credit policy regulates the amount that can be borrowed to a client at a given time. It is indicative from fig 4.4 that the credit policy determines the amount of credit to be extend to a client. Maysami (2016) pointed out that a credit policy has to define single obligator limits to a respective class of clients as this is of help in managing the client’s individual portfolio.

Moreover, the findings of the study disclose that all respondents concur that the credit policies and procedures crafted by the institution address risk both at individual credit levels and portfolio level (Bracket 3 i.e. Question iii). The finding are supported by the literature which highlighted

credit policies to be an encapsulation of risk aversion. Question iv, posed the question whether ZMF frequently reviews its credit policy .The institutions credit policies are not frequently reviewed basing on the obtained statistics which show 87.5% of the respondent disagreeing strongly that policies are not frequently reviewed and 12.5% disagree to the fact. This poses to be a great ordeal to the institution as unfrequented reviews could lead to bad business.

### 4.2.3 Adoption of credit risk management practices

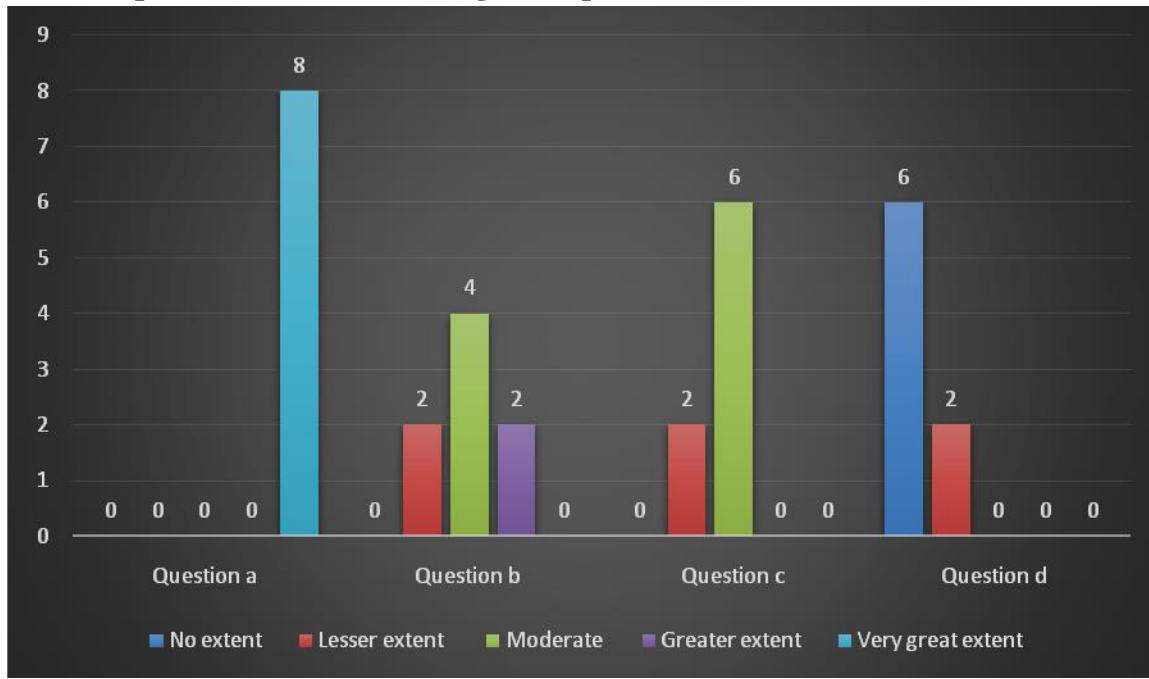


Fig 4.5

Findings from the study on the extent to which ZMF adopts stated CRM practices are shown in fig 4.5. Question a bracket, required respondents to state the extent on the importance of CRM. Results exhibit that CRM is to a very great extent important as depicted by the 100% respondent agreement. As highlighted by Mwisho (2011), the findings are in support to the fact CRM is of paramount importance. Furthermore, question b bracket posed to reveal the extent to which an appropriate credit administration measuring and monitoring process was employed at ZMF. 50% of the findings are concentrated on a moderate extent, 25% on a lesser extent and the other 25 % on a greater extent. It can be said that the institution employs credit administration and

monitoring practices but there are still gaps to be addressed. Rouse 2009, highlighted that nonperforming loans can be reduced if lenders pay attention to monitoring of clients through various ways. Moreover, the respondents express the same mind that monitoring control and review are significant in maintaining a good loan portfolio quality.

Moreover, as highlighted by the literature that an institution should have a management information system (MIS) producing accurate and timely reports and be effective in tracking payments, due loans and overdue loans in order to systematically monitor loan performance. From the findings, it is reflective that the respondents are not satisfied with the current management information system currently being used in the organization which is Loan Performer Version 8 as it seems to be inefficient failing to meet the demands of the institution.

Furthermore the respondents indicated that information sharing was not part of the organizational culture. In light of the findings by Galindo and Micco (2010) they highlighted information sharing as a strategy that should be employed by lenders to attenuate default rates. Failure to make use of information sharing results in an increase in the nonperforming loans reflecting on lax credit risk management practices.

In addition, the research bade respondents to enlighten on management practices employed by the organization in recovering defaulted loans. The findings are summarized below.

**Table 4. 5 Strategies employed to recover defaulted loans**

Factor	Frequency
Collateral	8
Monitoring and Evaluation	8
Legal Action	8

Source Primary data

The findings as reflected in the table 4.5 above show that all 3 scenarios of monitoring and evaluation, using collateral and legal action are employed in the organization as strategies to recover defaulted loans with all three strategies with a frequency level of 8 respondents acknowledging its use. This depicts that the entity uses all methods in different scenarios and circumstances to collect its debts. As cited in the credit policy, borrowings are principally



secured through collateral which is a strategy employed before a lender defaults standing as security in the case that the borrower completely fails to repay the borrowed amount

Furthermore, stringent monitoring and evaluation processes are cited as a strategy. In the event that a loan remains unpaid for over 365days which the entity considers a loss, legal action is then employed in a bid to recover its dues. Moreover, the institution makes use of telephones and emails as a method for collecting bad debts.

#### 4.2.4 QUESTION 3

The above information shows that credit risk management practices adopted by the bank influence the level of non-performing loans.

To what extent do the following credit risk management guidelines and practices influence the level of nonperforming loans? Use a scale of 1 to 5 were 5= Very great extent, 4= Great extent, 3= Moderate Extent, 2= lesser extent and 1= No extent

Factor	1	2	3	4	5
To what extent do proper credit risk management guidelines help in preventing an upsurge of nonperforming loans?					
ZMF has a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves?					
The institution takes into consideration potential future changes in economic conditions					

when assessing individual credits and their credit portfolios?					
The management information systems provide adequate information on the composition of the credit portfolio?					

**QUESTION 7(Questionnaire)**

In response to the question on how credit risk management can be enhanced as a strategy in bringing down the level of nonperforming loans, the respondents concur to the creation of a credit reference bureau. A credit bureau since it will have information on every one and cooperates it will enable the institution to review the client’s records and avoid giving debts to clients who are over laden with debts.

**4.3 INTERVIEW ANALYSIS**

Interviews were conducted with one credit officer, one monitoring and evaluations officer, one finance officer and the operations manager. 100% response rate was achieved as all 4 interviewee’s were interviewed.

**4.3.1 Question 1: What are the constituents of ZMF’s CRM policy?**

As alluded by the credit officer, it was pointed out that ZMF has a well-documented credit policy which spells out procedures, conditions and steps that are employed in granting credit. Further on, the officer added to saythe components of a credit policy should describe the products on offer, targeted clients, and approval thresholds among other factors. To this extent, from the interviews carried out the following were highlighted as the constituents of ZMFs credit policy by all four interviewees: products on offer, target markets, pricing and non pricing terms, credit

approval levels and thresholds on aggregate loan amounts, repayment terms, monitoring and control guidelines, risk identification and measurement processes, staff duties and responsibilities in governance of credit, loan administration and documentation procedures, standard for the management of problem loans and reporting requirements. Moreover the operations manager went on to deliberate that the credit policy is the constitution relating to credit in the institution and it is vital that it addresses all matters pertaining to credit offerings so that credit officers and all other employees are aware of what is required before extending a credit facility and what is required of them after disbursement.

ZMF, having a well-documented credit policy outlining various procedures and guidelines that ought to be undertaken before and after credit extension is a commendable effort, however that is just the first step. The greatest challenge becomes the implementation of these procedures and guidelines as mismanagement of this function poses dire dangers to the entity.

**Question 2: What are the key components of an effective credit risk management system?**

The key component of an effective CRM system at ZMF, is the control of credit procedures in order that loan loss provisioning for the various loan classes are maintained at their minimum as highlighted in the table below.

**Table: Loan Loss Provisioning of the Portfolio at Risk**

Days Past Due	Loan classification	Minimum Provisioning Rate %
Current loans and loans < 30 days past due	Normal/ Pass	1%
Loans Past Due 31-90 days	Watch / Special Mention	3%
Loans Past Due 91 – 180 days	Substandard	20%
Loans Past Due 181 – 365 days	Doubtful	50%

Loans over 365 days	Loss	100%
---------------------	------	------

Source Primary Data

In this regards, general provisions are to be preserved at 1% as a minimum of the outstanding performing balance of the aggregate credit facility were as specific provisions will be identified against present loans or probable loan loss.

**Question 3: What credit risk management practises are adopted before and after loan disbursements?**

The respondents highlighted that the overall lending process of ZMF is predicated on four key pillars which include Application, Review and Approval, Loan Disbursement and Loan administration as stated in the operations manual.

Before a loan is disbursed the respondents concurred that a review and appraisal process is conducted. Upon receipt of an application from a client, an appraisal process has to be carried out to determine the suitability of the applying client to tap into the institutions products and services. This process involves conducting a desk review and a field appraisal or due diligence.

The operations manager elaborated that the desk review entails checking for compliance with the legibility criteria. This process brings to light the credibility, suitability and appropriateness of the application in respect of alignment between the applicant and the institutions broad objectives. This step is to help mitigate risk of extending credit to a client who has no capacity to pay back. Furthermore, the manager added to say that a due diligence exercise is carried out to verify information provided on paper through physical visits. Investigative interviews with the management and staff of the institution being the client are carried out. This practice enables the organization to extend credit to applicants with a viable business that have the capacity to repay their dues thereby mitigating risk of default.

Moreover, monitoring and evaluation is another credit risk management practice adopted both before and after a loan has been disbursed as alluded by the monitoring and evaluations officer. After disbursement, loan monitoring and evaluation exercise is conducted for the purposes of following up on the progress of activities undertaken by the borrower as per the loan agreement and tracking the impact of these activities. In addition, it was highlighted that if a loan is used for

the intended purpose it reduces occurrence of NPLs. The process as alluded in the literature helps in identifying any signals of arising problems in relation to the clients operations likely to affect their business. As a result of the client having bad business it also entails the client defaulting in payments to the lender.

**Question 4: What are the effects of nonperforming loans to the entity and the microfinance sector at large?**

All four respondents expressed that NPLs reduce income for the MFI which turn significantly affects the profitability of the institution. The revenue obtained by MFIs is through interest earnings, therefore nonperforming loans result in revenue being tied up in debts. The institutions profitability is affected through diminished profits as institutions are required to create provision for bad debts. This is in line with IAS 39. Furthermore, two respondents highlighted that an entity faces liquidity challenges due to the revenue being sheltered in nonperforming loans. Moreover, all four respondents stated that the lending capacity of the institution is reduced as a result of NPLs. In agreement to the above finding, Rose and Hudgins (2011) explained that the reduction in lending capacity of an institution is proper gated by NPLs. Moreover, the finance officer acknowledged nonperforming loans to cause financial instability in the sector which can lead to a financial crises if it remains unattended too.

**Question 5: What other factors do you believe are causing nonperforming loans?**

All four respondents concur in identifying the following factors as other factors causing NPLs: diversion of funds, inappropriate timing of credit delivery, high interest rates, unemployment and information asymmetry. Two other respondents further on highlight business failure and express the need for credit risk management to be effectively implemented to do away with derisory monitoring and poor credit appraisal techniques.

**4.4 Chapter summary**

This chapter presented and analyzed data from the search findings through the use of tables, graphs, charts and descriptive summaries. The next chapter briefly summarizes the major findings of this research basing on the data presented in this chapter.

## **CHAPTER 5**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.0 Introduction**

This chapter provides a digest of the research, highlighting the key findings obtained from the data analysis. Furthermore, it provides conclusions to the study and presents recommendations thereon.

#### **5.1 Summary**

Granting credit being the income generating activity for microfinance institutions, the importance of credit risk management cannot be over emphasized to avoid baring the institution to gratuitously high risk levels. The study sought to investigate into credit risk management on nonperforming loans in microfinance institutions, targeting ZMF. The study sought to answer the question on the effect credit risk management has on the level of nonperforming loans. The study aimed to analyse ZMFs credit risk management policies, evaluate the institutions CRM practices, assess the effects that nonperforming loans has to the entity and the microfinance sector and to come up with ways in which CRM practices can be enhanced to eradicate the problem at hand. Furthermore, the study sought to applause ways to make stringent policies.

The findings revealed that the institution has a well-documented credit risk management policy that is duly authorized by the board and is implemented by the senior management. Furthermore, it confirms that the established institutions credit policies and procedures address risk in all institutional activities at both the individual credit and portfolio levels. It further brings to light that the institution does not frequently review its credit policy which entail the institution failing to take into consideration potential future changes in economic conditions when assessing individual credit and their credit portfolios.

The study further unearths that the institution has no reliable management information systems. MIS should afford entities sufficient information on the composition of credit portfolios enabling the institutions to measure the credit risk inherent in all on and off balance sheet activities.

## **Conclusion**

MFI's use different strategies to reduce the risk of loan defaulting. The most common as cited by the respondents includes having collateral against the loaned amount and having strict and thorough policies on lending. Other respondents also cited stringent loan evaluation procedures and having provisions to accommodate the default rate would shield them from high unexpected loan repayment default.

The study therefore answered the main research question on the effect that credit risk management has on the level of non performing loans in microfinance institutions. The study came to the conclusion that credit risk management is a key factor that raises the levels of non performing loans therefore stringent policies should be adopted to bring them to an acceptable low level.

## **Recommendations**

The Reserve Bank of Zimbabwe is currently experiencing an improvement in information sharing following the implementation of credit reference bureaus. This will over time reduce information asymmetries that exist in the market today for most microfinance institutions. However banks must respond to this by combining this information with different credit risk management techniques used to evaluate the clients by reviewing the lending terms and conditions of the clients.

The overall responsibility of risk management vests in a microfinance institutions board. The board should outline risk management strategy and formulate well-defined policies and procedures.

## **Suggestions for Further Research**

The study suggests that a further study should be undertaken to investigate the effect of the Credit Referencing Bureau in Zimbabwe on the Access of Credit Facilities from Zimbabwean

Microfinance Institutions. Further analysis should also be carried out to find out the credit risk management strategies that microfinance institutions use.

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## APPENDIX 1: QUESTIONNAIRE

### Instructions

1. Do not write your name on the questionnaire
2. Kindly tick or fill in your answer in the appropriate spaces provided to each question below:

### Part A: Respondent Information

1. Gender

Male  Female

2. Qualifications attained

Diploma  Degree  Masters  Doctorate

3. Term of service in the Organization

1 yr.  2 yrs  3 yrs  4yr  5yrs  6yrs and above

### Part B Company Environment

1. The following are questions on credit risk management policies. Indicate your response to each question by using a scale of Strongly agree=5, Agree= 4, Neutral= 3, Disagree=2, Strongly disagree=1

<b>Factors</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
Does ZMF have a well-documented CRM policy?					
Do CRM policies determine amount to be disbursed to a given client at a given time?					
Do the credit risk policies and procedures developed address credit risk in all institutional activities and at both the individual credit and portfolio levels?					
Is the credit policy frequently reviewed?					

2. The following are credit risk management practices. To what extent does ZMF adopt them? Use a scale of Very great extent=5, Great extent = 4, Moderate Extent= 3, Lesser Extent=2, No extent =1

<b>Factor</b>	<b>No extent</b>	<b>Lesser extent</b>	<b>Moderate Extent</b>	<b>Greater Extent</b>	<b>Very great extent</b>
How important is CRM?					
To what extent does the institution maintain an appropriate credit administration measurement and monitoring process?					

Do you have a good MIS in place to ensure that exposures approaching risk limits are brought to the attention of senior management?					
Is Information sharing part of the organizational culture ?					

**3** To what extent does the following credit risk management influence the level of nonperforming loans? Use a scale of 1 to 5 were 5= Very great extent, 4= Great extent, 3= Moderate Extent, 2= lesser extent and 1= No extent

Factor	1	2	3	4	5
To what extent do proper credit risk management guidelines help in preventing an upsurge of nonperforming loans?					
ZMF has a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves?					
The institution takes into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios?					
The management information systems provide adequate information on the composition of the credit portfolio?					

4. What is the relevance of the monitoring and control process on loan portfolio quality?

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5. What Credit Risk Management strategies do you have for recovering defaulted loans?

Using Collateral       Monitoring       Legal action       Other

If other specify-----  
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6. What is the method used in your organisation for collection of bad debts?

Telephone       Email       Personal visits       collection agencies

7.                      In your opinion, how can credit risk management be enhanced as a strategy to bring down the level of nonperforming loans?

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**\*\* Thank you for your co-operation \*\***

## **APPENDIX 2 INTERVIEW GUIDE COVER LETTER**

Midlands State University

P Bag 9055

Gweru

05 April 2017

Zimbabwe Microfinance Fund

9<sup>th</sup> Floor Causeway Building

Cnr 3<sup>rd</sup> & Central Avenue

Harare

To whom it may concern

### **REF: INTERVIEW TO SOLICIT FOR INFORMATION**

My name is Tafadzwa Simbarashe Chambati, a fourth year undergraduate student at Midlands State University studying a Bachelor of Commerce Honors Degree in Accounting. In partial fulfillment of the requirements of the degree, I am carrying out a research entitled, “An Investigation into Credit Risk Management on Nonperforming Loans in Microfinance Institutions.

Information obtained will be for academic purposes only and will be treated with strict privacy and confidentiality. Please assist by answering the questions below.

Your Cooperation will be greatly appreciated.

Yours Sincerely

Tafadzwa Simbarashe Chambati ( R143936P)

## **APPENDIX 2 INTERVIEW GUIDE**

### **INTERVIEW QUESTIONS**

1. What are the constituents of ZMFs credit risk management policy?
2. What are the key components of an effective credit risk management system?
3. What credit risk management practices are adopted before and after loan disbursement?
4. What are the effects of nonperforming loans to the entity and the Microfinance sector at large?
5. What other factors do you believe are causing nonperforming loans?

**\*\* Thank you for your co-operation \*\***