AN ASSESSMENT OF CREDIT RISK MANAGEMENT TECHNIQUES ADOPTED BY MICROFINANCE INSTITUTIONS IN KENYA

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DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

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This management research project has been submitted for examination with my approval as university supervisor.

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DEDICATION

I dedicate this research project to my dear wife, Teresa, and my sons, Brandon and Mark, for their love, understanding and patience when I could not be with them because of my studies. May God bless you mightily.

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LIST OF ABBREVIATIONS

MFIs	Microfinance Institutions
SMEs	Small and Medium Enterprises
MSEs	Micro and Small Enterprises
NGOs	Non Governmental Organizations
ILO	International Labour Organization
CBK	Central Bank of Kenya
SPSS	Statistical Package for Social Sciences
AMFI	Association of Microfinance Institutions
CBS	Central Bureau of Statistics
6 C's	Character, Capacity, Conditions, Collateral, Contribution, and Common Sense

ABSTRACT

Microfinance, the provision of financial services to poor people, holds enormous potential to support economic activities and thus contribute to the alleviation of poverty. Widespread experiences and research have particularly shown the importance of savings facilities for the poor. Micro credit systems have been developed in response to the needs of small-scale entrepreneurs who otherwise do not have access to finance. To be able to continue giving credit, borrowers from MFIs and commercial bank offering micro-credit products should repay as agreed and on time. Successful and effective credit risk appraisal and evaluation determines the success of the credit journey. An established credit risk management process ensures that this journey succeeds.

The study focuses on the credit risk management techniques that have been adopted by MFIs and banks offering micro-credit products with objective of assessing the techniques.

To satisfy the objective of the study, primary data was collected, by use of a questionnaire from 25 MFIs and 6 banks offering micro credit. The primary data was supplemented by information obtained from brochures and direct interviews to clarify answers on the questionnaires. The data was analyzed by use of statistical package for social sciences (SPSS) that is used internationally for statistical analysis. The results have been presented in form of frequency tables, graphs and percentages.

The findings of this study are that a significant number of 92.5% (37 out of 40 respondents) have credit risk management policies as a basis for objective credit risk appraisal and that they involved their employees in developing the credit risk management policies. Most of the institutions used the credit manual to sensitize their employees about credit risk management. It was also found that most institutions have distinctive separate departments where micro credit activities are organized, an indication of growth in the development of micro credit institutions in the country. It was also found that most of the institutions work with pre-set targets that are closely monitored and that micro credit departments had specific credit officers. Further, the study found that a majority of the institutions that as early as one late repayment, a loanee was considered a defaulter and thus collection efforts were intensified. This partly explains why

microfinance institutions command low default rates. On dealing with difficult-to-repay-on-time clients, the study found that most indicated the preferred method was sale of property to recover the money, followed by write-off of the balance while others would consider writing off the interest and allowing defaulters to repay the principal loan only. Further, most of the institutions used the 6 C's criteria and that capacity/completion was the most important factor followed by contribution and character, and reasonableness (common sense) of cash flows from business. This finding is not consistent with assertions by Mutwiri (2003) who found that character was the most considered followed by capacity/completion and common sense/reasonableness, in commercial banks.

Further, the study established that the most important risk that they face was credit risk followed by interest rate risk and technological risk, and that they used swaps followed by forwards, futures and lastly options to manage the risks. This finding is consistent with Abedi (2000) who found that liquidity risk and credit risk are the most important risks that banks in the U.S.A. face.

CHAPTER ONE

INTRODUCTION

1.1 Background

Microfinance, the provision of financial services to poor people, holds enormous potential to support economic activities and thus contribute to the alleviation of poverty. Widespread experiences and research have particularly shown the importance of savings facilities for the poor. Micro credit systems have been developed in response to the needs of small-scale entrepreneurs who otherwise do not have access to finance. Without money, it is not possible to purchase inputs that are required to establish business and improve on productivity. Therefore those people who operate with the least amount of surplus income to finance their businesses are in need of this external credit and are considered to be least credit worthy (Khandker, 1990).

The Grameen bank in Bangladesh pioneered micro credit through lending to members of groups. Group members provided security and due to peer pressure within group members encouraged each other to ensure prompt payment of the loans. The main objective of MFI's is mainly to provide financial assistance through establishing saving schemes, offering loan products to the general public and the Small and Medium Enterprises (SMEs). The key function of MFI's is to provide a way to transfer economic resources through time, across borders and among individuals. MFI's can take the form of Government institutions and NGO's (Yunus, 1998).

In Kenya, the idea of micro credit can be traced back before independence. The colonial government did not provide credit facilities to the African people, and hence informal credit groups such as merry go-rounds were formed within the societies in rural areas and clan levels. During the 1970s, government agencies were set up and their main responsibility was focused to provide credit to those who had no previous access to credit facilities (Dondo, 1999).

The government and donor community assumed the poor required cheap credit, and as a result credit unions were set up in an effort to mobilize savings amongst poor people. The favourable attitudes and policies towards micro enterprise both worldwide and locally, owe much to the 1972 ILO mission to Kenya. The report highlighted the limitations of the previous industrial development policies in Kenya and by a large extent, much of the development world (Henry, 1991).

Micro credit arose in the 1980's as a result of research recommendations about government delivery of subsidized credit to poor people. Micro finance projects were set up by international aid organizations and local institutions, such as Microfinance Institutions in Poland with a sole purpose of promoting small business enterprises. In the developing world, the aim of micro finance is that of helping others help themselves (Hulme, 1997).

While MFIs and commercial banks have faced difficulties over the years, for a multitude of reasons, the major cause of serious financial problems continues to be directly related to credit standards for borrowers, poor portfolio risk management or lack of attention to changes in the economic circumstances and competitive climate (Central Bank Annual Supervision Report, 2000). In the framework of the financial system approach, adequate credit risk management techniques of the micro-finance institutions increasingly move into the center of attention to ensure the safety of their clients' deposits and the institutions' revenue generation (Littlefield, 2003).

A large portion of Kenyan financial institutions' revenue is generated from credit extended to various individuals and organizations. This revenue is in the form of interest earned and charges on the preparation and management of the credit process (Central Bank Annual Report, 2001). According to Clarke (1999), awarding credit is a journey, the success of which depends on the methodology applied to evaluate and to award the credit. This journey starts from the application for credit and ends at the time the loan from the credit process is fully paid. Like any human journey, the credit management process has got smooth paths, impediments and detours before the destination is reached.

Therefore, the credit needs to be effectively controlled for it to succeed eventually. Credit control can rightly be said to start when the client walks into the office. If during the discussion, with the client, the credit manager finally agrees to grant credit or lend money the lender has embarked on the journey called credit control and the nature of that journey will directly be influenced by the quality of that decision (Clarke. et al, 1999).

The credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower. Risk is a decision problem including a lending one that has several basic elements. First, there must be an individual or group that is faced with a problem, that is, a decision maker. The problem might be whether to award credit or not. The decision maker must be seeking to achieve some objective or desired outcome, like to earn revenue from successfully awarded loans overtime. Several alternative actions or strategies, which can possibly achieve the stated objective, must be available to the decision maker. In addition a state of doubt must be available to the decision-maker about which alternative action is best in seeking to achieve the desired objectives. Finally the problem exists within an environment consisting of all factors that the outcome cannot be controlled completely by the decision maker (Luce, et al, 1957).

This framework is applicable in a wide variety of decision-making situations on the basis of whether the decision is made by an individual or a group and according to whether it is effected under conditions of certainty, risk, uncertainty, as well as a combination of uncertainty and risk. The characteristic of decision-making problems, among the four categories, is determined by the knowledge of the possible outcomes that will occur when one or more alternative actions are chosen in a decision problem. Luce and Raiffa (1957) assert that lenders make decisions on the basis of risk. Risk is a decision-making situation in which there is variability in the possible outcomes and the decision maker can specify the probabilities of these outcomes. It refers to the potential variability of outcomes from a decision alternative. The more variable these possible outcomes are, the greater is the risk associated with the decision alternative. Risk is the possibility that the actual return on an investment or loan lent will deviate from that, which was expected. Expectations are continually revised on the basis of new information to minimize the overall risk.

Numerous approaches have been developed for incorporating risk into decision-making process by lending organizations. They range from relatively simple methods, such as the use of subjective or informal approaches, to fairly complex ones such as the use of computerized simulation models (Luce and Raiffa 1957). Many lending decisions by financial institutions are frequently based on the decision maker's subjective feelings about the risk in relation to expected repayment by the borrower. Financial institutions commonly use this approach in decision-making because it is both simple and inexpensive (McGrugan et al. 1993).

In the past few years, Kenya's financial institutions have been hit by a crisis that has led to the collapse of indigenous financial institutions and contributed to a crisis of confidence that threatens to permanently damage the sector (CBK Annual Supervision Report, 2000). This crisis coming at a time of serious economic hardships was a great impediment to economic expansion.

Risk management, in the broadest sense, means protecting all of the institution's assets: - monetary, physical and human, from all potential dangers. For financial institutions the more, subtle risks to consider are embezzlement, misuse of information and damage to the institutions through irresponsible acts of a director or an employee. Many people consider risk management in financial institutions as an unpleasant task. After all it means looking at potential events that are negative or undesirable. Nonetheless, risk management is an inescapable direct responsibility of the financial institution's officials, particularly the risk involving around credit management. Many MFIs find carrying out a thorough credit risk assessment and evaluation, a substantial challenge. For traditional bank lending, competitive pressures and the desire for growth create time constraints that interfere with basic due diligence (Greuning and Bratanovic, 1999).

While each organisation would have its own method of determining risk and quality of its clients, depending on the large group, the following risk evaluation concepts are useful for most occasions. The concepts the researcher will study in this survey are referred to as the 6 Cs of credit appraisal (Edward, 1997). Many financial institutions and other business organizations use the 6 Cs model to evaluate credit applications from their existing and prospective customers. As the name suggests, the 6 Cs model has six elements in appraising the credit worthiness of prospective customers; namely character, capacity/completion, condition, collateral, contribution and common sense (Edward, 1997).

Measurement of credit risk can be considered from the perspective of probability theory. The process of measuring loss potentials and assessment and evaluating their impact on banks and financial institutions legally leads to credit risk control and financing and a thorough risk analysis, assessment and evaluation before granting credit to prospective customers.

1.2 Statement of the Problem

A major issue that is gaining entry into the micro credit sector is the growing of competition within the banking industry (Baydas et al, 1997). The increase in the number of banks and other financial institutions fighting for the formal banking sector has led to a glut in the sector. A large number of international banks are taking over corporate banking business, forcing many local banks into retail business. The liberalization within the banking sector in the mid 1990s has led buildings societies to rethink their strategies and ended up in micro-credit after realizing that this is one market that remains largely untapped (Coetzee et al, 2002).

Subjective decision making by the management of microfinance institutions may lead to problems associated with credit. This includes extending credit to business enterprises they own or with which they are affiliated, to personal friends, to persons with a reputation for non-financial acumen or to meet a personal agenda, such as a cultivating special relationship with celebrities or well connected individuals. A solution to this may be the use of tested lending techniques and especially quantitative ones, which filter out subjectivity (Gruening, et al, 1999).

The goal of credit risk management is to maximize a financial institution's risk-adjusted returns by maintaining credit risk exposure within acceptable parameters. Financial institutions need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any financing organization (Sinkley, 1992).

There are indications that borrowers from microfinance institutions have a lower default rate than borrowers within commercial banks (Annual Reports K-REP, 2001; Annual Reports KCB, 2001). Given this low default rate, it becomes necessary to seek to understand what credit risk management techniques MFIs have adopted and how best to employ them.

1.3 Objective of the Study

The objective of the study was to assess the credit risk management techniques adopted by microfinance institutions in Kenya.

1.4 Significance of the Study

The study is important to the following:

Banks - The study will assist banks in their endeavour to cultivate better methods of managing credit for the SME sector. Banks will understand the issues that are faced within the sector and the factors that determine success.

Microfinance Institutions - Microfinance Institutions (MFIs) in Kenya will use the research findings and the knowledge gained to assist them as they commercialize. Microfinance institutions are faced with the need to adopt sustainable methods of delivering services which can be achieved by offering sustainable products, of which the default rate is a crucial part.

Government policy makers - The Government formulating policy that relates to the regulatory environment of the country as far as micro credit activities are concerned. As the sector grows, the government has to come up with policies that address the various challenges within the sector to reduce any resultant chaos and to facilitate faster growth with minimum drawbacks.

Future researchers and scholars – The study will help in facilitating an increase in the general knowledge of the subject and will act as a reference material to future researchers and scholars who may wish to embark on related studies. Research in the various components of the sector will help to unearth hitherto unknown information that will go along way in facilitating further understanding of the micro credit sector.

CHAPTER TWO

LITERATURE REVIEW

2.1 Micro Finance Institutions

Institutional performance has been a worrying issue especially in the corporate world. This is more particular to micro financing institutions. The concept of the micro-financing institutions can be traced back in 1980's with the Grameen bank of Bangladesh, which was established as a pro-poor bank (Yunus, 1998). Micro financing organizations were supposed to meet the financing needs of itinerant traders of the informal sectors enterprises especially in the areas where formal banks could not operate. Since then these institutions have occupied a central place in the socio economic development and empowerment of the poor in both the developed and under developed countries (Dondo, 2000).

Management, including that of microfinance institutions, entails developing sustainable competitive strategies and ultimately to efficiently and effectively plan and organize business activities and control use of resources, in order to achieve desired objectives. The main objectives of organizations, including MFIs, are to maximize owner's equity. Successful management of all such plans and organizations may be upset by the occurrence of unseen events, hence risk (Abedi. 2000).Therefore, continuous planning, coordinating, organizing and controlling of activities and resources, including effective credit appraisal and evaluation, in order to minimize risk of lent funds, are the major concerns of risk management among microfinance institutions in Kenya (Annual Reports K-REP, 2001; Annual Reports KCB, 2001).

2.2 Microfinance Institutions and Credit Provision

Microfinance Institutions have provided the largest volume of credit to the SMEs. The market for small loans in Kenya has remained under-served for a long time and therefore filled by the Microfinance Institutions (Coetzee et al. 2002). The Government of Kenya is also in the process or developing a framework within which Microfinance providers will fall (GoK, Budget speech, 2002/2003).

Small and Medium Enterprises, (SME's) have been of special attention to organizations and governments worldwide especially in developing countries. In Kenya, they have been considered important because of job creation, generation of revenue to the government and enabling the sustenance of the individual and the growth of trade and supplying of goods and services (GoK, Budget speech, 1997/1998).

SME's generate more direct jobs per dollar of investment than do large enterprises. They serve as a ground for developing technical and entrepreneurial skills and by virtue of their greater use of indigenous technological capabilities; they promote local inter-sectoral linkages and contribute to the dynamism and competitiveness of the economy (Aryeetey, 1997).

2.3 Financial Needs for SMEs

Small and micro enterprises have faced persistent pressure when seeking funds for investment. The SMEs cannot easily access funding because they have underdeveloped businesses that have a very short history hence banks are often not willing to lend using conventional methods. Furthermore, the promoters lack securities that can be given to lenders or guarantee other investors into other business and, the promoters have neither the education nor the ability to convince investors or financial intermediaries. Owners may also not have a saving history with a financial intermediary that can form the basis for savings-led credit. This possibly explains why banks in the past few years have relocated from rural and suburban areas rendering potential customers in these areas to have no access to credit (Coetzee et al, 2002). SMEs need credit for new investment in business, operational activities, and for growth of the business.

Investment in business: SMEs require funds as start up capital for investing in new ventures that they may have come up with. Rukwaro (2000) observes that most SMEs obtain funds from own sources, including savings and from friends, citing the fact that few creditors are willing to lend for start up businesses.
fund

Operational purposes: SME s need funds so that they can purchase raw materials, supplies and carry out activities that they need to facilitate the production process. SMEs may make sales on credit hence need for bridging funds as they await repayment. Studies have found that most fund; received from credit institutions are used fur working capital (Gatune, 2002).

Growth of Business: As SMEs grow, they require funds to finance growth n fixed assets and increase working capital. SMEs therefore require longer-term credit n ever increasing amounts. SMEs obtain such funds from formal institutions as well as own funds since many micro credit institutions lack the appropriate programs to finance such growth. Studies indicate a high drop out rate from MFIs is that remain rigid, insisting on group methodology and lower amounts of loans for customers, who have progressively graduated to higher loan requirements (Graham, 2000; Gatune, 2002; Rukwaro, 2000).

Other purposes: Promoters of SMEs need lumpsum funding to finance personal issues so that they can repay the credit using income generated from business. "Often, loans are diverted to "providential" or "non-productive" purposes, to meet emergency medical or education expenses. It is increasingly clear that to tie loans to specific uses without addressing other needs and opportunities is naïve at best" (Graham, 2000).

2.4 Sources of Funds for SMEs

Small and Medium Enterprises, (SME's) source funds through equity/own funds or, through debt. Internal/own funds include accumulated savings from likely strategic investors who become part owners (Rukwaro, 2001; Atieno, 1998). SMEs also access credit, which requires repayment with interest or when given as a grant, with no interest. In a few situations the SMEs may be awarded grants and they may not be required to repay. Access to credit has been limited mainly to microfinance institutions and informal institutions like money lenders and rarely do the commercial banks lend to the sector to provide micro credit and other financial services to the sector. Studies show that commercial banks provide the lowest amount of financing to SMEs and where it is provided, the credit is rationed (Atieno, 1998).

These organizations range from small charitable units operating in a limited geographical area to large institutions covering vast tracts of the country for a variety of development and welfare activities. Increasingly organizations have emerged whose sole objective is providing financial services to micro and small enterprises, for example the Kenya Rural Enterprise Programme (K-REP), Kenya Women Finance Trust (KWFT) and Faulu Kenya. NGOs can develop micro finance assistant models that are cost effective and lead to sustainability. Many have adopted the principle of the Grameen Bank of Bangladesh with this aim in mind. Some of the most serious weaknesses of NGOs credit schemes are related to the method of funding, nearly all are donor supported or sponsored. Donors often provide facilities and create a cost base, which the NGOs cannot sustain on their own. The schemes therefore last only as long as the donor is willing and able to support them (Dondo, 1999).

The main sources of financing for micro finance institutions includes; equity from owners, concessional loans with below market rates from credit unions (for example Oiko Credit, MESPT, Stromme Foundation), venture Capital (as in the case of Equity bank and K-REP banks from AFRICAP), strategic investors (e.g. Opportunity International: WEDCO and K-REP), commercial banks loans, donor grants and donor loans (private convertible capital).

2.5 Classification of MFIs

Financial institutions offering micro credit are classified on the basis of emphasis on micro credit at the time of establishment of the institutions, a majority of the Institutions being NGOs that have always offered and continue offering micro credit; other NGOs started out purely as micro finance institutions, but have since evolved and operate as commercial banks offering both formal and micro credit services (Glosser 1994) as those institutions were started out as banks and have since diversified into offering either, more credit alongside conventional banking products or, strictly micro credit products such as

Bank Raykat Indonesia (Boomgard et al, 1994); and, banks that were set up primarily as microfinance banks e.g. Centenary Bank in Uganda (Baydas et al, 1997).

The SME sector is ripe for entry of more banks because banks have the network necessary to offer loans to the sector. The commercial banks are therefore stable and can lend, given, appropriate lending methodologies, to a larger number of people hence realizing a bigger impact. Moreover, banks have the resources to expand further and lend more money. They are unlike most NGOs that rely heavily on donor and government support, which is drying up. Governments are beginning to realize the impact of the small and micro enterprise sector on the economy and are therefore availing mechanisms that will facilitate its growth (GoK Budget speech, 2003/2004).

Governments have realized the need to de-link themselves from competing with the private sector and that subsidizing the sector has worked to its disadvantage. There is effort towards regulation as well as encouraging private banks to get more involved in the sector (Coezee, 2002). The Kenyan Government is in the process of finalizing a sessional paper on the SME sector, which will encourage entry of more players (Budget speech, 2003/2004).

2.6 Requirements for Successful Micro Credit Providers

Successful micro credit activities for financial institutions must be driven by among others the following:

i) Oketch (2001) highlights commitment and the institution's culture whereby the financial institution must treat the micro credit sector as part of the areas within the institution where profits will be made;

ii) Staff must be appropriately rewarded and motivated to work towards improving business and limit delinquencies administrative structures should be put in place to ensure that the institutions are able to monitor their loans from analysis to repayment;

iii) Development of appropriate lending technologies that fit the particular clientele so that the borrowers can benefit from the loan programs as well as repay the loans with interest to limit default rates.

The necessary capacity in terms of human resources must-be in place to ensure that staff are able to appraise loanees, and follow up on loans made (Otero et al, 1994).

Other factors include: sound credit management policies and procedures, sound administrative structures, a robust loan tracker (for example STAR at Pride Africa), corporate governance and adherence to micro finance best practices (CGA-AP, SEEP, and CALMEDOW).

2.7 Risk

Risk refers to the potential variability of outcomes from a decision alternative. It can also be defined as the exposure to change or the probability that some future events will occur making the expected and actual outcome to differ. The wider and regular the variability, the greater the risk.

2.7.1 Types of risks faced by Financial Institutions

According to Butterworths (1990), there are numerous risks, facing today's financial institutions. These risks are interrelated hence their effective management is of utmost importance to the performance of financial institutions. Some of these risks are explained below.

Market risk is the risk of losses in financial institutions on and off-balance-sheet positions arising from movements in market prices that change the market value of an asset or a commitment is described as the market risk. This type of risk is inherent in banks holding of trading portfolio securities, financial derivatives and open foreign exchange positions and in interest-sensitive bank assets and liabilities. As explained bellow, examples of market risk include foreign exchange risk, interest rate risk, liquidity risk and risk involved in derivative transactions.

Foreign exchange risk refers to the risk of losses in on-or-off-balance-sheet positions arising from adverse movements in exchange rates. The risk tends to be most closely identified with cross border capital flows, (Thygerson, 1995). Banks are exposed to this risk in acting as market makers in foreign exchange by quoting rates to their customers and by taking unhedged open positions in foreign currencies. This may occur when; first, banks are involved in spot and forward exchange markets and secondly banks taking unhedged open positions in foreign currencies (e.g. bank borrowing from abroad).

Interest rate risk refers to the exposure of a bank's financial condition to adverse movements in interest rates. This risk arises as a result of a mismatch (gap) between a bank's interest rate sensitive to assets and liabilities, and affects both the earnings of a bank and the economic value of its assets, liabilities, and off-balance-sheet instruments. Excessive interest rate risk may erode a bank's earnings and capital base (Hempel, el al. 1994). The primary forms of interest rate risk are: first, repricing risk, which arises from the timing differences in the maturity and repricing of bank assets, liabilities, and off-balance-sheet positions and secondly, yield curve risk, which arises from imperfect correlation in the adjustment of the rates earned and paid on different instruments of otherwise similar repricing characteristics.

Interest rate risk is particularly a problem for MFIs operating in countries with unpredictable inflation rates, which directly affects interest rates on debt.

Liquidity risk is the risk that arises from financial institution's inability to meet its obligations as and when they fall due without incurring unacceptable losses. Inadequate liquidity affects profitability, and in extreme cases, can lead to insolvency. In the case of cross-border transactions, there is an additional foreign exchange liquidity risk that may arise from first, a sudden interruption to banks access to foreign funding and, secondly, absence, in general, of a lender-of-last-resort facility by the Central Bank for foreign exchange transactions.

Risk in derivative transactions: Derivatives are an increasingly common method of taking or hedging risks. The actual cost of replacing a derivative contract at current market prices is one measure of a derivative position's exposure to market risk. (Saunders, 2002). Since many of these transactions are registered off-balance sheet, supervisors need to ensure that banks active in these transactions are adequately measuring, recognizing and managing the risks involved. Examples include the interest and foreign exchange rate dominated transactions (swaps, options, forward, futures, etc.) of residents with other residents and non-residents and technology risk, which occurs when technology investments do not produce the anticipated cost savings in operating costs and increased profits.

Credit risk is the risk that the customer, or counter party of the bank will be unable or unwilling to meet a commitment that it has entered into with the bank, that is, the failure of counter party to perform according to a contractual arrangement. The risk applies not only to loans but also to other on-and off-balance-sheet exposures such as guarantees, acceptances, and security investments (Hempel, el al. 1994). Additional dimensions of credit risk in the context of cross-border transactions include: -

Transfer risk, which occurs when the currency of obligation becomes unavailable to the borrower regardless of its financial condition.

Country risk, which is the risk associated with the economic, social, and political environment of the borrower's country. It is the risk that repayment from foreign borrowers may be interrupted because of interference from foreign governments

2.7.2 Other Types of Risks

Other risks that a financial institution may be exposed to include:

Operational risk is the risk related to the bank's overall business. The risk mostly focuses on capital requirements' and the whole operating activities of the bank. (Grenning and Bralanovic, 1999).

Event risk is the risk resulting from sudden and unexpected changes in financial market conditions due to events such as war, revolution or sudden collapse of stock market and breach of fiduciary trust.

The above are some of the major types of risks faced by commercial banks. However, the most significant and the major focus of this study is the Credit Risk. This study focused on credit risk in terms its appraisal, assessment and evaluation.

2.8 Risk Management

Butterworths (1990) asserts that effective risk management, from the viewpoint of financial institutions, is the key to the future success in banking and therefore these institutions should focus on professional management of risk. The successful financial institutions are, and will increasingly be those that develop focused strategies, lower their overhead ratios, ingeniously exploit their advantages and know how to calculate their risks.

The most important areas of concern to MFIs in credit risk management is integrative in terms of risk an MFI is taking in doing business by client, by channel, by product, by business, by industry, by currency and by country. MFIs will be put out of lines of business as well as of areas, where the risk they are taking is disproportionate compared to the profits they make or hope to make (Hempel, et al 1999)

2.8.1 Prerequisites to Risk Management

One of the most important prerequisites of risk management is that of planning for the unknown. This requires asking questions such as; how do we know when a diversity will hit and how hard? Have we examined ahead of time where our financial staying power lies? Do we know what is to be our line of defence against any risk associated with a line of business we are entering into? Secondly, can we anticipate, rapidly respond and cope with changes in the business environment?

Operating a financial business has always been a mailer of foreseeing and rapidly coping with change. Banks and other financial institutions and their customers keep constantly changing. Therefore all financial institutions should focus on providing quality services in the areas of financial service, investment advice, mergers or acquisitions, corporate finance, restructuring, arbitrage, sovereign lending, recycling, and rescheduling (Thygerson, 1995).

Every one of these product titles suggests activities quite different from classical money lending; yet the banking business is still basically the same as that of lending money to make money. This creates a tremendous conceptual gap and sometimes leads to unwarranted risk taking. To a large measure adapting to the new environment means changing culture, altering not only the way we have been operating in the past, but adapting new ways of thinking and doing business (Thygerson, 1995).

2.9 Credit Control Policy and Risk Management in Microfinance Institutions

There is need for an effective credit control policy to manage credit risk. Hence, in order to ensure a fairly healthy credit management program, with minimal expensive bad debts, and minimized credit risk, a company strives to establish an effective credit control and lending policy. Surprisingly, a few companies do not have any such policy and even more worrying, many of the companies with credit control policies still fail to operate the policies so much so that the companies' debts soar and seriously affect the companies' very existence, in terms of profitability and a health cash flow (CBK Survey. 2001).

Credit control policy is the general guideline governing the process of giving credit to the firm's customers. The policy sets the rules on who should get what credit and when and why one should get the credit including repayment arrangements and necessary collaterals. The method of assessment and evaluation of risk of each prospective applicant are part of a credit control policy.

2.9.1 Credit Policy Objectives

A company's credit policy objectives include: sales revenue increases through deepening on sales; encourage movement of slow moving stocks; a competitive tool to gain a competitive advantage in the market; minimize cost of idle cash; encourage growth; to effectively avoid customers nobody else wants; minimize credit risk taken by the firm; and minimize non-performing loans in the case of microfinance institutions.

Financial institutions usually consider many factors when setting up a lending policy (Abedi 2000). However, the lending policy should be in line with the overall organizational strategy. Nevertheless, the factors considered include: the existing credit policy, industry norms, general economic condition in the country and the prevailing economic climate. Further, the general trend of credit extended by other leaders, the more generous the credit they give to their customers; hence the more a firm can afford to be lenient with its debtors. The cost of a firm's overheads and the costs of credit management may influence the credit control policy in that if these costs are heavy the firm may not wish to extend too much credit, assessment, evaluation and monitoring tools available, credit risk to the organization, including pace of technological development and changes that will enhance credit follow up as well the 6 C's characterization of the customers will impact on the firm's credit control policy (Abedi 2000).

A firm's credit policy may be lenient or stringent. In the case of a lenient policy, the firm lends liberally even to those whose credit worthiness is questionable. This leads to higher borrowing, high profits, assuming full collections of the debts owed. With the stringent credit policy, credit is restricted to carefully determined customers through a thorough credit appraisal system. This minimizes costs and losses from bad debts; however it may reduce revenue earnings from credit profitability and cash flow (Abedi 2000).

Every financial institution bears a degree of risk when the institution lends to businesses and consumers and hence experiences some loan losses when certain borrowers fail to repay their loans as agreed. Principally, the credit risk of a bank is the possibility of loss arising from non-repayment of interest and the principal, or both, or non-realization of securities on the loans. This concept is not different from non-banking institutions Credit perspective.

2.10 The Six C's of Credit Risk Assessment and Evaluation Model

According to Abedi (2000), banks use the 6 C's to evaluate a customer as a potential borrower. The 6 C's help banks to decrease the risk of default, as they get to know their customers. According to Abedi (2000), these 6 C's are:

Character: Character is the maturity, honesty and trustworthiness, integrity, discipline, reliability and dependability of a customer. Character is no doubt the most important quality of any client. A person of good character will pay his debt whether it is secured or not. Such a person will disclose all the facts of his deal because his intentions are to seek guidance and help from the organization. When in problems, such borrowers will adhere to the credit manager's request for alternative arrangements to pay his debt instead of hiding from the bank. The business of charge and credit cards is based primarily on the character of the cardholders. A person's character can be determined through: Personal interview, reference from people who know the client well, personal knowledge of the client and record of past performances.

Capacity/completion: capacity refers to a client's ability to service his debt fully. Even if one had good intentions but has no funds he will not be able to keep his loan repayment up to date. A client's capacity can be determined by retrieving his resources of income and netting off the commitments. In the case of a company, an analysis of the Audited Accounts for the past three years could reveal the surplus available to service the loan. For hire purchase, bank loan or charge card, the practice is to determine a client's current capacity, since injection of the loan may not have sufficient influence on the client's capacity to generate income. For venture capital, the picture is completely different. Capacity is based on projections and hence integrity of such projections is quite crucial.

Capacity also refers to a client's record of performance. A client who has borrowed money from various institutions and paid regularly over long periods can be described as having experience of borrowing and paying. The client is disciplined and is likely in keep the good record. Occasionally, credit managers come across clients who will tell them that they are good borrowers because this is their first loan. Unfortunately, one cannot say so because these clients are inexperienced. They are virgins in loan management and repayment.

Condition: Condition refers to the overall environment. Is the commercial socio-economic, technological and political environment conducive to a successful implementation of the project? Are there any illegal impediments and detours to the successful implementation of the project? .For example, if someone wants a loan to invest in drugs business, a very profitable but illegal undertaking, would he qualify for a loan?

Collateral: This is the security given to secure the loan, in terms of non-encumbered assets. Perhaps the most talked about, but the least important, in terms of eventual credit success of the six C"s is collateral or security. Businesses like credit and charge card's, do not even consider collateral thus the least important (CBK. 2002). Further more, some collateral are difficult to dispose of to recover the loans and in some industries and situations there are lots of indifference's that make it almost impossible to dispose of the collateral.

Contribution: is the client committed to the project at hand. Is he willing and able to make contribution? If it is a hire purchase, is he able to raise the 40% deposit or is the deposit borrowed from a third party making the project 100% loan financed. If a client is having difficulty raising the deposit, he is likely to be unable to pay his instalments regularly. Is the client willing to contribute his time to the management of the projects or asset? Absentee management has been the main cause of failure of many projects in this country. For example, oil companies are insisting that petrol stations must be owner managed. What about where large sums of money are involved? Shouldn't owner management be mandatory?

Common Sense: This is the natural ability to make good judgement and behave in a practical and sensible way. Being prudent and reasonable in analyzing, presenting, using and interpreting financial, data and other related business information.

Additionally, common sense is the reasonableness of the financial information provided to support the case for financing a project as an indication of the ability of the project to pay for itself.

While each of the above factors is important on their own right, they, however, should not be considered in isolation. While adverse record on each one is enough to reject an application, good reports on all the aspects improve the probabilities of success. Therefore, these elements can be used individually or in combination, depending on the level of quality of credit appraisal required and the amount of credit involved. The 6 C's model is meant to help financial institutions in Kenya to thoroughly evaluate and assess the credit worthiness of existing and potential customers before awarding them new or further credit and hence exposure of banks and the avoidance of non-performing loans. The 6 C's model covers the entire area of credit risk and hence its application in credit risk appraisal will ensure that banks and financial institutions protect their assets against loss (Abedi. 2000).

2.11 Credit Appraisal Criteria in MFIs

The guiding principle in credit appraisal is to ensure that only those borrowers who require credit and are able to meet repayment obligations can access credit. Lenders may refuse to make loans even though borrowers are willing to pay a higher interest rate or make loans but restrict the size of loans to less than the borrowers would like to borrow (Mishkin, 1997). Financial institutions engage in the second form of credit rationing to reduce their risks.

There are two arguments on how much credit the SMEs should be given. One school of thought argues that the SMEs know best what they want to invest in and thus they should be given what they apply for (Reinke, 2001). The author further argues that some credit schemes assume that the poor people themselves know best how to better themselves and thus, credit should be targeted to particular activities. In Cameroon and Togo, consumer and investment credit is provided and there is no constraint on how loans are used (Gurgand, 1994)

The other argument contends that credit should be made available according to repayment capability based on current performance. Some of the factors of determining the size and target for credit include:

Savings: Gurgand (1994) notes that mandatory and voluntary savings schemes have been used effectively by Rural Finance Institutions (RFIs) where savings play a significant role in gaining access to credit. Cr'edit e'pargne-logement in Rwanda provides 5 to 15 years credit for home construction after one year of recorded saving efforts Reinke (2001) identifies savings as a means of determining who to give credit and how much, whereby a borrower is required to accumulate savings both prior to and after borrowing. The borrower may also be required to pledge such savings as collateral. This excludes the potential borrowers and contradicts logic of micro lending in that the borrowers may not have funds to save.

Ability to pay: In Burkina Faso and Malawi, failure of one member to repay was used to block access to new credit for all group members, increasing repayment performance due to social pressure (Gurgand 1994). Reinke (2001) notes that instead of blocking all the group members, access to future larger loans may be made dependent on punctual and full payment of small initial loans.

Evaluation of business ability: This approach is practiced in Burkina Faso whereby a careful analysis of the economic opportunities available in the villages where credit is provided is carried out. Use of credit is discussed with borrowers and includes a variety of firm or non- firm investments. The scheme is flexible allowing reallocation of funds to activities that had not been previously planned.

Target group: Target groups are also used to allocate credit. Gurgand (1994) found that Smallholder Agricultural Credit administration (SACA) in Malawi concentrates on small holder farmers, cr'edit soudure in Burkina Faso concentrates on poor people in rural Sahel that suffer lack of capital with emphasis on women. Other organizations target group. Among the ways identified include, target women who are seen as economically less independent, the youth due to high unemployment and insufficient jobs and the rural people who are seen not to benefit from development and employment creation in the cities and towns. A lender has to decide how to reach his target group and ensure that targeting objectives are met. A number of micro finance loans are targeted towards the employed class in order to minimize default.

Others: The other factors identified by Reinke (2001) include such factors like ethnicity, nationality or factors of social disadvantage such as physical disability, location and objective of the micro credit institution and mandatory framing. Objective of the lender may be to fund activities away from the trading activities so as not to dilute the sector's profit thus undermining the viability of ail trading activities An MFI serving the poor may locale its offices where the poor live. Such criterion may sometimes lead to poor choices as cities and towns have the best infrastructure connections. Access to credit may be conditioned on undergoing credit training. This may be worthy as more borrowers will succeed in their business and be able and willing to repay their loans. However, training is costly and it will exclude some potential borrowers.

2.12 Peer Lending and Structured Disbursements

Peer or group lending as commonly called, reduces *credit risk* by spreading the risk of lending without collateral over large number of borrowers within the group as the group acts as the insurance cover for the institution. Most MFIs use a structured disbursal mechanism (2-2-1 for five members, "watanos" for K-Rep) whereby those members of the group that have not received a loan become *agents* of the MFI in debt collection (actual plus pressure) so that they can have access to their loan also. The credit officer's work is also transferred to the group who has to do overtime here, because they have interest. The un-received loans therefore act as a bate for the chase on early repayment.

For example in K-Rep, each group of *watanos* meet every week and discuss business which includes issues on emergencies (e.g. social loans), savings contributions, deposit of savings contribution for the previous week, loan repayment and group guarantee for new loan grants; the group must pass each members loan and appraise the business to be financed.

2.13 Character Assessment and Graduated Loan System

MFIs must develop expertise at assessing the characteristics of their borrowers and become familiar with characteristics that reduce loan default rate. One way of developing this expertise before granting a loan is demand good; track record of loan repayment, savings habits, progress on business enthusiasm and enterprise development and attendance of group meetings for the individual borrowers.

Once the MFI is satisfied that the client has exemplified these characteristics, consideration should be made to offer graduated loans and confirm the repayment reputation and capacity to handle large loans. The MFI should begin with small and less risk loans and increase the loan size gradually as experience with the customer is gathered.

Forced savings or group guarantee: Forced savings and group guarantee act as the surrogates for formal collateral. In most cases mandatory savings precede loan granting, and at the point one takes a loan they are taken as a deposit guarantee (often a certain percentage of the loan).

Small loan sizes: The small loan sizes and the huge number of borrowers in microfinance are a way of diversifying risk for the MFI. Micro credit loans have a standard size, an average of about $450. The idea is first, to reach as many people as possible with credit - hence small to accommodate all, but this happens to spread the risk of default through a diversity of clientele thereby reducing chances of loss – especially for these borrowers are carefully selected.

Obviously growth has complicated this model, as many MFIs have had to burst this limit ($450). However, to stay in the microfinance – lower end market, one is forced to grow horizontally rather than go up-market.

The advantage with this approach, which is indeed a best practice in microfinance, is that, more and more risk is spread across a spectrum of small clients to the extent that a default will only contaminate a very small portion of the entire portfolio. This phenomenon has placed the portfolio quality (PAR) for microfinance institutions at a higher level than formal commercial banks. In Kenya, the PAR (90 days) for banks is 40% while the same is 12 % for MFIs.

Term structure of loans: To reduce liquidity risk, an MFI should design loans with different and flexible term lengths - both short and long term. Common short term periods are; weekly, a month, six week -'majuma sita', three and six months. Long terms ranges from, 6 months to 8 months for farmers, one year and goes up to 18 months for big projects. The term should be related to the nature of enterprise and flow of cash flow. Repayment should be discussed with every individual borrower or pre-arranged by the MFI after the above considerations.

Loan approval process: Loan approval process is a key driver of portfolio quality. As the loan size increases, an MFI should move towards a credit committee appraisal system (assesses, appraise and approve). This reduces the chances of making poor decisions resulting to dishonest and problematic clients. It removes the bias in selection and increases the control for loans that pose a greater financial risk to the institution (transaction and fraud).

The responsibility to approve a loan should be weighted evenly as per loan size across the hierarchy of decision makers. That is, the primary group, secondary group, credit officer, credit manager, operations and chief executive.

Centre collection: To eliminate transaction and fraud risk, the credit officers or agents of the MFIs should not handle client money. Since clients cannot steal their own money, they should bear the responsibility of collecting repayment and depositing the same at a specified financial institution.

For many MFIs, client groups undertake to collect loan repayment for their members (under the supervision of the credit officer), appoint one of their own that deposits the money in a group joint bank account, and only discuss the banking (bank slip and statement which must be seen by all) in their next meeting. The credit officer merely provides information on group transactions as an independent confirmation, since s/he is a signatory to the joint account.

2.14 Review of Past Studies

Oketch (1995) studied the demand and supply of MSEs finance in Kenya and established that the size of loans to various borrowers depends on the lending methodology where when funds are lent to individuals, appraisal depended on business assessment, collateral, business needs and replacement capacity, type of business and availability of funds. For group based loans it depends on age of the group appraisal of the project, past repayment records, demand by clients and availability of funds.

Oketch used the SMEs financiers and did not consider the influence of rationing on MSEs operations. Oketch's findings contribute to this study in defining the possible variables from the perspective of the SMEs such as credit size and security. Rukwaro (2000) took the perspective of both the SMEs and their financiers and went further to determine the influence of credit rationing on operations of SMEs and indeed concluded that credit rationing impacts negatively on operations of SMEs.

Mudiri (2003) found out that there were two credit models employed in Kenya by institutions offering micro-credit, namely, the Grameen (group based) model and the individual loan model. He also found out that banks based their products on individual loan model while majority of the MFIs products were based on the Grameen model. Mudiri asserted that whichever model was used, a product had an equal chance of success. However, he said that products under the individual model were likely to do poorly than those under the Grameen model if other factors were not well managed.

Mutwiri (2003) found that the 6 C's model is essential in credit risk appraisal and that the most critical factors of the six C's model were character, capacity/completion and common sense in that order. Mutwiri also established that the most important risk for banks was liquidity risk followed by credit risk and that banks used forwards and swaps to manage these risks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

The section covers the research design, population and sample size, data collection methods and procedures and data analysis.

3.1 Research Design

The survey design was used in this study.

3.2 Population

The target population of interest was the Microfinance Institutions (MFIs) and banks offering micro credit in Kenya.

There are hundreds of institutions that carry out micro-finance activities in Kenya, some organized within churches, some organized as cooperative societies, and others operating on part-time basis. The population of registered micro-finance institutions in Kenya comprise of 64, according to the K-REP register of MFIs, the Association of Microfinance Institutions of Kenya and the Central Bank of Kenya. There are also six banks offering micro credit services, that is, one building society, two specialized microfinance banks and three commercial banks.

The population targeted by this study constituted the 6 banks and 64 registered Microfinance Institutions.

3.3 Sampling

The sample frame constituted the commercial banks offering micro credit and microfinance institutions. The researcher adopted both the stratified random sampling technique as well as convenience sampling. The stratified random sampling technique was used to select banks and registered MFIs within Nairobi, which are 31 in number.

Convenience sampling was used in selecting the finance or accounting departments of the selected microfinance institutions, where the researcher took two respondents. The two respondents were the accounting or finance managers; and the head of credit department or head of section handling micro-credit services, as appropriate. This yielded a total sample of 50 respondents from MFIs and 12 from the banks offering micro credit. The total sample was 62 respondents.

3.4 Data collection method

The names and addresses of Microfinance Institution (MFIs) in Kenya were obtained from the Association of Microfinance Institutions, Central Bank of Kenya and the KREP register.

Data was collected from primary sources through a semi-structured questionnaire, administered to the managers of the commercial banks and microfinance institutions. The drop-and-pick-later method was considered appropriate because it gives the respondents time to fill the questionnaires and gives the researcher an opportunity to review the questionnaire before picking it for completeness in responses. Secondary data was obtained to reinforce collected data from brochures and supplements in newspapers covering micro credit providers.

3.5 Data analysis

Data was analysed using descriptive statistics such as percentages and tabulations with the help of the SPSS Package. The analysis was carried out on the credit risk management approaches of different microfinance institutions when offering micro credit. Comparative analysis was done to identify any differences in techniques used by MFIs and the banks offering micro-credit services.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

This chapter presents the analysis of the data collected and interpreted on the assessment of credit risk management techniques adopted by Micro Finance Institutions and banks offering micro credit services in Kenya.

4.1 Data Collected and Analyzed

Data was collected from 31 institutions located in Nairobi and its environs out of the 48 institutions targeted. The questionnaire was administered using the drop-and-pick later method. The data was collected from heads of Finance, accounting and/or credit departments at the MFIs as well as heads of various units handling micro credit at the selected banks. The institutions that did not respond gave various reasons including sensitivity of financial information requested; only a few senior officers could authorize release of information and the said officers were out of office on official matters, while others feared misuse of the information requested. Brochures were obtained from specific institutions to clarify information on products offered.

Out of the 62 questionnaires that were distributed, 40 were returned. This represents a response rate of 65%, which is considered significant enough to provide a basis for valid and reliable conclusions with regard to credit risk management techniques adopted by Micro Finance Institutions and banks offering micro credit services in Kenya. This is well explained in table 4.1 below:

Table 4.1 Overview of data collected

Population	Number of Institutions	Sample (t)	Returned questionnaires (r)	Non-Response Error (t-r)
MFIs	25	50	33	17
Banks	6	12	7	5
TOTAL	**31**	**62**	**40**	**t-r=22**

Key: t = Sample; r = Returned Questionnaires; t – r = Non-Response Error (35.4%)

Source: Research Data

4.2 Background Information of the Institutions Studied

4.2.1 Ownership of the institutions

When respondents were asked about ownership of their organizations, a majority of 57.5% said the institutions were private, 20% were owned by the public, government owned another 12.5% while NGOs owned the remaining 10%. This shows that most of the institutions are mostly managed by private firms and individuals in Kenya.

Table 4.2 Ownership of MFIs and Banks

	Ownership	
	No. of respondents	Percentage
Government	5	12.5%
NGOs	4	10.0%
Private	23	57.5%
Public	8	20.0%
Total	**40**	

Source: Research Data

4.2.2 Involvement in micro credit

All the 40 respondents (100%) indicated that they were involved in micro credit services. The analysis further showed that all the MFIs and banks offer micro credit to small scale entrepreneurs, a clear indication of a better future in terms of entrepreneurial behaviour and thus better living standards for the Kenyan citizens.

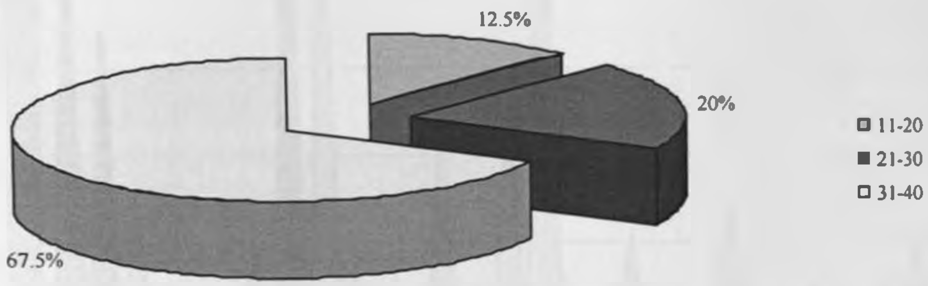
4.2.3 When micro credit was introduced

When asked when micro credit was introduced in their institutions all the respondents (100%) indicated that micro credit was introduced right on the inception of the institutions. From this response, we can say that the MFIs were formed with the aim of offering Micro credit.

4.2.4 The Number of outlets offering micro credit

As can be seen in figure 4.1 below, 67.5 % of the MFIs studied have 31-40 outlets, 20.0 % of MFIs own between 20-30 outlets while only 12.5% of these institutions own between 11-20 outlets. This shows a positive growth of Micro Finance Institution outlets.

Figure 4.1 The Number of Outlets Where Micro Credit is Offered



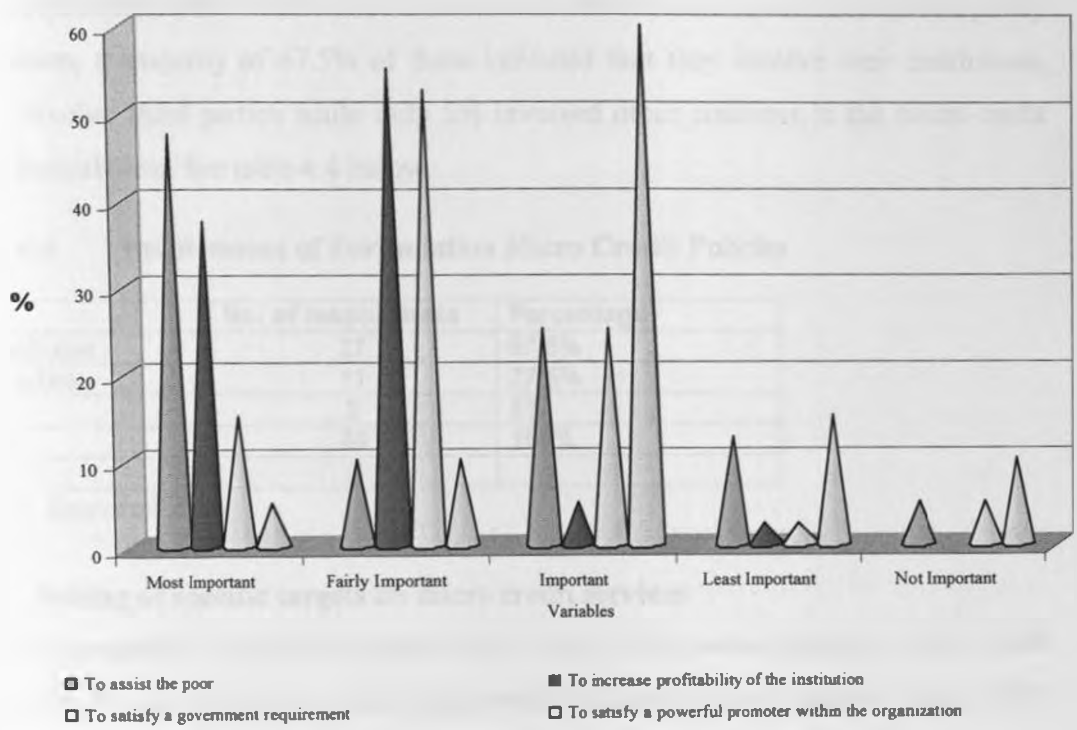
Source: Research Data

4.2.5 The reasons why micro credit services were introduced in the organization

When asked the reasons why micro credit services were introduced in their institutions a majority of the respondents, indicated the most important reason was to assist the poor (47.5%), to increase profitability of the institution (37.5%), to satisfy a government requirement (15%) and to satisfy a powerful promoter within the organization (5%).

On the same question, the respondents indicated the fairly important reason for introducing micro credit in their institutions was to increase profitability of the institution (55%), to satisfy a government requirement (52.5%), to assist the poor (10.0%), and to satisfy a powerful promoter within the organization (10.0%).

Figure 4.2 Reasons as to Why Micro Credit was Introduced in Organization



4.3 Management of Micro Credit Activities

4.3.1 Existence of a specific micro credit policy

It was revealed that a significant number of 92.5% (37 out of 40 respondents) have guiding policies while only an insignificant number of only 3 respondents (7.5%) have not yet come up with the same. This is a positive trend, and will enhance performance since policies leads to a formalized credit evaluation process and specifies how every transaction is to be done.

Table 4.3 Existence of Specific Micro Credit Policies

	Has specific policies	No specific policies	Total
No. of respondents	37	3	**40**
Percentage	92.5%	7.5%	**100%**

Source: Research Data

4.3.2 Involvement in the formulation of credit policy

When respondents were asked about their level of involvement in the micro credit policy formulation, a majority of 67.5% of them indicated that they involve their institutions, 27.5% involve third parties while only 5% involved other concerns in the micro credit policy formulation. See table 4.4 below.

Table 4.4 Involvement of Formulation Micro Credit Policies

	No. of respondents	Percentage
The institution	27	67.5%
Third parties	11	27.5%
Other	2	5%
Total	**40**	**100%**

Source: Research Data

4.3.3 Setting of specific targets on micro credit services

When respondents were asked whether they work with pre-set targets, 35 out of 40 (87.5%) said they work with pre-set targets while an insignificant number (5 out of 40) comprising 12.5% does not work with targets. The trend is impressive and shows that MFIs and banks offering micro credit set targets to enable performance monitoring of the services thus leading to better management.

Table 4.5 Whether the Institution Sets Targets for Micro Credit Services

	Has set specific targets for micro credit services	No specific targets set for micro credit services	Total
No. of respondents	35	5	**40**
Percentage	87.5%	12.5%	**100%**

Source: Research Data

4.3.4 Monitoring of the set targets as compared to monitoring of other services

When asked how the monitoring of the set targets compared with monitoring of targets of other types of services, a reasonable number of 75% observed that the pre-set targets compares favourably with the other types of services, while a small percentage (20%) of the respondents indicated that there is lower emphasis on targets than on the other products/services in their MFIs, and lastly an insignificant 5% indicate of other options which they did not specify.

Table 4.6 Monitoring of Sets Targets as Compared to Other Services

	No. of respondents	Percentage
Favourably comparable	30	75%
There is lower emphasis than other products	8	20%
Other comments	2	5%
Total	**40**	**100%**

Source: Research Data

4.3.5 Existence of credit officers

It appears that somehow a number of micro credit institutions do have credit officers, 62.5% of the respondents implied that their micro credit departments had specific credit officers while only 37.5% did not have these officers. This is an indication that the micro credit institutions are moving towards reasonable levels of perfection.

Table 4.7 Existence of Specific Credit Officers

	Has specific credit officers	No specific credit officers	Total
No. of respondents	25	15	**40**
Percentage	62.5%	37.5%	**100%**

Source: Research Data

4.3.6 Organization of the micro credit activities

From the analysis below (table 4.8), most institutions have distinctive separate departments where micro credit activities are organized as indicated by 67.5% of the respondents, as opposed to 30% who indicated that micro credit activities are offered by a unit within a department. This is an indication of growth in the development of micro credit institutions in the country.

Table 4.8 Organization of the Micro Credit Activities

	No. of respondents	Percentage
Within a separate department	27	67.5%
A unit within a department	12	30%
Other	1	2.5%
Total	**40**	**100%**

Source: Research Data

4.3.7 Factors to consider in establishing a credit control policy

When asked to rank the factors to consider in establishing a credit control policy, majority of the respondent indicated that they mostly considered overhead costs (47.5%), the general trend of credit extended to the organization (27.5%), the state of the economy (30%) and the existing credit policy (25%) in that order.

Table 4.9 Factors to Consider In Establishing a Credit Control Policy

Ranking	Existing credit policy	Overhead costs	General trend of credit extended to your organization	The state of the economy
Least considered	75	52.5	72.5	70
Most considered	25	47.5	27.5	30

Source: Research Data

4.3.8 People who formulate your credit policy

When asked to rank the people who formulated the credit policy in their institutions, majority of the respondents indicated that in most cases executive management formulated policies (90%), while others felt (60%) said that credit managers or equivalent made the credit policies, others felt that employee suggestions (45%) and credit analyst (45%) led the formulation of policies, still others felt that the board (32.5%) and the credit committee (22.5) led in formulation of policy. This clearly shows that the practice is diverse and there was a mix of who formulated credit policies.

Table 4.10 People Who Formulate Your Credit Policy

Ranking	Executive management	Employee suggestions	Board of directors	Credit manager	Credit analyst	Credit committee
Least formulated	10	55	67.5	40	55	77.5
Most formulated	90	45	32.5	60	45	22.5

Source: Research Data

4.3.9 Regularity of review of credit policy

When asked how regularly they reviewed their credit policies most respondents (52.5%) indicated that this was done quarterly while another 32.5% indicated that the review was yearly. There were others (10%) who reviewed their policies half-yearly while another insignificant 5% did not indicate how regular the review was.

Table 4.11 Regularity of Review of Credit Policy

	No. of respondents	Percentage
Quarterly	21	52.5
Half-yearly	4	10.0
Yearly	13	32.5
Other	2	5.0
Total	**40**	**100%**

Source: Research Data

4.4 Credit Risk Management process

4.4.1 Credit appraisal process

When asked about the credit appraisal process, a reasonable number of 67.5 agreed that it is very objective as compared to only 32.5% who said it is very subjective in nature. This shows that the credit is appraised in most of the cases in an objective manner.

Table 4.12: Credit Appraisal System

Ranking	**No. of respondents**	**Percentage**
Very subjective	13	32.5%
Very Objective	27	67.5%
Total	**40**	**100%**

Source: Research Data

4.4.2 How to make employees aware of credit risk

When asked how they sensitized employees on credit risk, a majority of the respondents (67.5%) said they used the credit manual while another 62.5% said they used 'one-to-one' supervision to make employees aware of credit risk issues. There still others (47.5%) who used regular training as a way of communicating credit risk to employees. The least used method was regular meetings (42.5%).

Table 4.13: How to Make Employees Aware of Credit Risk

Ranking	Regular meetings	Regular training	Using supervision on one to one basis	credit manual
Method least used	57.5	52.5	37.5	32.5
Method most used	42.5	47.5	62.5	67.5

Source: Research Data

4.4.3 Credit appraisal using the 6 C's criteria

To establish the criteria used by the institutions in evaluating credit risk, the respondents were asked to specify which factors they considered when appraising, assessing and evaluating credit risk to their customers. As shown in table 4.14 below, the factors most considered were capacity/completion (65%), contribution (65%), character (62.5%), reasonableness of cash flows from business (62.5%), condition (52.5%) and finally, collateral/security (52.5%).

Table 4.14 Factors Considered in Credit Appraisal

Factor	Least considered		Most considered	
	Frequency	%	Frequency	%
Character of borrower	15	37.5%	25	62.5%
Capacity/completion	14	35.0%	26	65.0%
Condition	19	47.5%	21	52.5%
Collateral /security	19	47.5%	21	52.5%
Common sense/reasonableness	15	37.5%	25	62.5%
Contribution	14	35.0%	26	65.0%

Source: Research data

4.4.4 Credit risk assessment and credit approval levels

The respondents were asked to indicate who does the credit risk assessment in their institutions and who approves credit risk at various levels. As shown on table 4.15 below, the credit risk assessment is mostly done by the Credit Manager, followed by the credit committee, branch manager, then Managing Director/General Manager and least by the Chairman.

Table 4.15 Credit Risk Assessment

Ranking	Chairman	Managing director/General Manager	Branch Manager	Credit Manager/ Head of credit	Credit Committee
Most involved	25	37.5	57.5	67.5	62.5
Least involved	75	62.5	42.5	32.5	37.5

Source: Research data

As indicated in table 4.16 below, most of the respondents stated that the Managing Director mainly approves credit of more than Ksh 1.5M while the Credit Manager approves credit amounting of less than Kshs 1.5M. The branch manager approves credit of between 500k – 1M.

Table 4.16 Credit Approval levels (Kshs. Millions)

Ranking	Up to 500,000	500,000 - 1,000,000	1,000,000-1,500,000	1,500,000-2,000,000	2,000,000 and above
Managing Director	12.5	7.5	12.5	57.5	62.5
Credit Manager	40	35	57.5	17.5	15
Branch Manager	47.5	57.5	30	25	22.5

Source: Research data

4.4.5 Defaulting on loan repayment

When respondents were asked at what time they considered a loanee to have defaulted, a majority (62.5%) indicated that as early as one late repayment, a loanee was considered a defaulter and thus the collection effort would be intensified. This partly explains why microfinance institutions command low default rates.

Table 4.17 Loan Default Consideration

Ranking	One late payment	Two late payments	Three late payments	Five late payments
Least	37.5	37.5	37.5	37.5
Most	62.5	62.5	62.5	62.5

Source: Research data

4.4.6 Dealing with difficult to repay clients

When the respondents were asked how they deal with difficult to repay clients, a majority indicated the preferred method as sale of property to recover the money (67.5%) followed by write-off of the balance (55%) while another 32.5% would consider writing off the interest and allowing defaulters to repay the principal loan only.

Table 4.18 Dealing With Loan Defaulters

Ranking	Use auctioneers to recover the debts	Sale of their property to recover the money	Leave them alone to decide when to pay	Write the debt off and account it as bad debts	Write off interest and allow them to pay the principle
Least done	25	32.5	72.5	45	67.5
Most done	15	67.5	27.5	55	32.5

Source: Research data

4.4.7 Importance of various risks and how managed

The respondents were asked to state the importance of various risks. As stated on table 4.19 below the most important risk is credit risk (80%) followed by interest rate risk and technological risk (62.5% each), market risk (57.5%) and lastly foreign exchange risk (40%).

Table 4.19 Importance of Risks

Ranking	Foreign exchange risks	Technological risks	Interest rate risks	Market risks	Credit risks
Least important	60	37.5	37.5	42.5	20
Most important	40	62.5	62.5	57.5	80

Source: Research data

When asked how they managed the various risks, most respondents (60%) said that they used swaps followed by forwards, futures and lastly options.

Table 4.20 Management of Risks

Ranking	Futures	Forwards	Swaps	Options
Least used	52.5	45	40	72.5
Most used	47.5	55	60	27.5

Source: Research data

4.5 Factors Affecting Business Performance

Most of the institutions did not want to reveal their financial performance statistics but were asked what factors they considered as having impacted on financial performance in the last five years (2001 – 2005), they ranked improved credit appraisal as the least considered (82.5%) while saying that the most important factors that impacted on performance was customers not willing to repay (65%).

Table 4.21 Factors that have Affected Organization Financial Performance in Last Five Years (2001 – 2005).

Ranking	Improved loan collection methods	Customers not willing to repay MFI loan	Charged too high interest rate	Poor economic conditions	Improved credit appraisal
Least considered	52.5	35	40	55	82.5
Most considered	47.5	65	60	45	17.5

Source: Research Data

4.6 Strategic Management Factors

4.6.1 Long term strategy

All the respondents (100%) indicated that their institutions have a long term strategy to maintain micro credit activities. This shows favourable attitude towards micro financing and an indication of future growth in these organizations.

4.6.2 Source of funds for micro credit activities

Table 4.22 Sources of Funds Used for Micro Credit Activities

Ranking	**No. of respondents**	**Percentage**
Internally generated funds	14	35.0%
Customer savings	13	32.5%
Donor funds	13	32.5%
Total	**40**	**100%**

Source: Research Data

As can be shown from the table above, the respondents indicated that 35% of the funds came from internal sources while 32.5% said the funds came from customer deposits and another 32.5% came from donor funds.

CHAPTER FIVE

SUMMARY OF FINDINGS AND CONCLUSIONS, RECOMMENDATIONS, LIMITATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH

5.1 Summary of Findings and Conclusions

The objective of the study was to assess the credit risk management techniques adopted by microfinance institutions in Kenya. To satisfy the objective of the study, primary data was collected, by use of a questionnaire from 25 MFIs and 6 banks offering micro credit. The primary data was supplemented by information obtained from brochures and direct interviews to clarify answers on the questionnaires. The data was analyzed by use of statistical package for social sciences (SPSS) that is used internationally for statistical analysis. The results have been presented in form of frequency tables, graphs and percentages.

The research findings reveal that:

All the 40 institutions studied (100%) indicated that they were involved in micro credit services. The analysis further showed that all the MFIs and banks offer micro credit to small scale entrepreneurs, a clear indication of a better future in terms of entrepreneurial behaviour and thus better living standards for the Kenyan citizens.

The institutions studies also indicated that they started offering micro credit services right from inception, an indication that MFIs were set up with micro credit as one of their principal services.

A majority (67.5 %) of the MFIs studied have a bigger number of 31-40 outlets showing a positive growth of Micro Finance Institution outlets. A majority of the respondents indicated the most important reason why micro credit services were introduced was to assist the poor (47.5%), to increase profitability of the institution (37.5%), to satisfy a government requirement (15%) and to satisfy a powerful promoter within the organization (5%).

A significant number of 92.5% (37 out of 40 respondents) have credit management policies as a basis for objective credit risk appraisal. A majority (67.5%) indicated that they involve their institutions to develop credit management policies Also a majority of the respondents (67.5%) said they used the credit manual to sensitise their employees about credit risk. A majority (47.5%) of the respondents indicated that they mostly considered overhead costs when setting up credit policies.

Most institutions (67.5%) have distinctivc separate departments where micro credit activities are organized. This is an indication of growth in the development of micro credit institutions in the country. 87.5% said they work with pre-set targets and that 75% observed that the monitoring of the pre-set targets compares favourably with the other types of services. 62.5% of the respondents indicated that their micro credit departments had specific credit officers.

Majority of the respondents indicated that the credit risk assessment is mostly done by the Credit Manager, followed by the credit committee, branch manager, then Managing Director/General Manager and least by the Chairman.

A majority (62.5%) indicated that as early as one late repayment, a loanee was considered a defaulter and thus the collection effort were be intensified. This partly explains why microfinance institutions command low default rates. On dealing with difficult-to-repay-on-time clients, a majority indicated the preferred method was sale of property to recover the money (67.5%) followed by write-off of the balance (55%) while another 32.5% would consider writing off the interest and allowing defaulters to repay the principal loan only.

Most of the institutions used the 6 C's criteria and used all the C's appraising their borrowers in the following order: capacity/completion (65%), contribution (65%), character (62.5%), reasonableness (common sense) of cash flows from business (62.5%), condition (52.5%) and finally, collateral/security (52.5%).

Majority of the institutions ranked credit risk (80%) as most important risk followed by interest rate risk and technological risk (62.5% each), market risk (57.5%) and lastly foreign exchange risk (40%). This finding is consistent with Abedi (2000) who found that liquidity risk and credit risk are the most important risks that banks in the U.S.A. face.

On management of the various risks a majority of the institutions (60%) said that they used swaps followed by forwards, futures and lastly options.

5.2 Recommendations

Effective credit risk management is critical for the success of MFIs in these days of global competition. It is therefore recommended that:

To fulfil the key objectives of MFIs mainly to assist the poor and increase profitability of the institution, the micro credit products will need to be managed in a more robust manner.

MFIs should, in addition, have credit management policies as a basis for objective credit risk appraisal. They should involve their employees in developing credit management policies to ensure ownership and home-grown credit policies. MFIs should use the credit manuals to sensitise their employees about credit risk.

MFIs are encouraged to train in-house credit officers for effective credit risk management

MFIs considered a loanee to have defaulted as early as one late repayment and immediately set up steps to intensify collection efforts. This partly explains why microfinance institutions command low default rates. While many MFIs preferred method of dealing with defaulters was sale of property to recover the money, a number wrote off the interest and allowed defaulters to repay the principal loan only. This ensures that you do not lose the principal sum and in a way helps meet the objective of supporting the poor.

MFIs are encouraged to apply the 6 C's of credit risk appraisal model in their credit risk evaluation as applied in commercial banks. In a study of applying the 6 C's model on commercial banks, Mutwiri (2003) found that character was the most considered followed by capacity/completion and common sense/reasonableness, collateral and least considered was contribution

MFIs should continue to rank credit risk as most important risk in their business.

5.3 Limitations of the Study

The extent of the study was limited by time to collect all the questionnaires from the respondents, which may have led to different and improved conclusions. Furthermore, time also limited the degree of analysis of the data that could have improved the conclusions reached in the study.

Financial resources were also limiting factors, in that with more resources a more sophisticated study would have been carried out. Further, 22 questionnaires were not received back, their inclusion of which might have led to different conclusions.

The study was limited in that it only focused on the MFIs located in Nairobi thereby introducing an element of geographic bias, however due to nature of information required it was not possible to get data out of Nairobi. Inclusion of the other MFIs located in various parts of the country could have changed the findings reached.

5.4 Suggestions for Further Research

MFIs are slowly expanding their activities and recruiting more clients for their micro credit products, due partly to more donors' funds and as a result of building up internal funds. A study on the internal control systems in place at the MFIs is recommended.

With the current debate on the Micro finance bill, the regulatory framework of MFIs should be of concern to researchers.

There is also need to conduct a study the group dynamics in the group lending methodology while it would also be of interest to study whether the borrowers from MFIs graduate to borrow from formal commercial banks especially now that banks are offering micro credit.

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GLOSSARY

Loan Products: Types of loans with particular sets of terms and conditions, and often for a particular use.

Micro Credit: Micro credit may be defined as the credit given mainly to low-income entrepreneurs or the informal sector to finance them in their businesses. The loans may be provided by both the formal sector and the informal sector.

Micro and Small Enterprise: The study adopts the definition given by the 1999 National MSEs Baseline Survey whereby a micro enterprise refers to any business that employs not more than 10 people. A small enterprise is one that employees between 11 and 50 persons (CBS 1999). Employment here refers to people working in the enterprise whether paid or not. Business enterprise or firms are used interchangeably to refer to an economic unit producing goods or providing services, for example salons, kiosks, among others.

Microfinance: The Association of Microfinance Institutions (AMFI) defines Microfinance as the provision of micro credit as well as other services such as savings, deposits, insurance services and other financial instruments/products aimed at the poor or low income people. This study will focus on the micro credit aspect.

Microfinance Institution (MFI): This is an institution set up and primarily dealing with the provision of micro finance services. It can be a Non-Governmental organization, savings and credit co-operative societies, credit unions, government banks, commercial banks or non-bank institutions.

Banking Institution or Bank: This is an institution that is allowed by law to accept deposits and give advances under various statutes.

Development Banks: These are banks that are constituted only to deal with specific sectors such as agriculture etc. They give directed credit. This study is not concerned with development banks.

Default Rate: The rate at which loans become bad and cannot be collected unless legal process commences.

APPENDIX A

LIST OF MICRO FINANCE INSTITUTIONS IN KENYA

Action Aid

Akiba Microfinance Limited

Adventist Development relief agency

BIMAS

CARE International in Kenya

Charity Development For family

Council of International Development pride

Cross bridge Credit Ltd

Dandora Catholic Church

Daraja Trust Co. Limited

ECLOF

Family Finance

Faulu Kenya

Food for the Hungry International

Fridrich Ebort Stiftung

Hope Africa

Horizon Kenya Co. Ltd

Imani Marianists

K – MAP: Kenya Management Assistant Programme

Kamukunji SACCO

Kenya Cats by Trust

Kenya Commercial Bank Special loan unit

Kenya Rural Enterprise programme

Kenya Small Traders Society

Kenya Women Finance Trust

Kenya Agency for Development of Enterprise and Technology

Micro – Kenya Ltd

Partnership for productivity Kenya

PCEA Bahati Community Centre

Post Bank

Pride Africa Drumnet

Pride Ltd

Pride Management Services Ltd

Provide International

SISDO micro finance

Small Micro Enterprise Programme (SMEP)

Sun link

Undugu society of Kenya

Techno Serve International

Women enterprise Development

Young Women Christian Association

Source: How to approach Banks: A guide for Kenyan Entrepreneurs (2002)

APPENDIX B

QUESTIONNAIRE

1. Institutional Information

Please indicate:

a) Name of institution ....

b) Location of main office ....

c) When the institution was established ....

e) Position of the respondent: ....

2. Ownership

a) Please indicate the proportion of ownership by each of the following

- Government ( )%
- Churches ( )%
- NGO ( )%
- Private ( )%
- Other, specify ( )%

b) Is your organization involved in micro credit?

Yes [ ] No [ ]

c) If yes, when was the micro credit introduced?

- On inception........................
- Any other (State the year) ....

d) Please indicate the number of outlets where micro credit is offered in your institution ....

e) Please rank the following in ascending order (i.e. with 1 as the main reason) the reasons why micro credit services were introduced in your organization.

- To assist the poor ( )
- To increase profitability of the institution ( )
- To satisfy a government requirement ( )
- To satisfy a powerful promoter within the organization ( )
- Any other reason. (Specify) ( )

3. Management of Micro credit Activities

a) Does the institution have specific micro credit policies?

Yes [ ] No [ ]

If yes, please highlight the percentage of involvement of your institution in formulating the micro credit policies for the micro credit products? (Use relative percentages)

- The institution ( )
- Third parties ( )
- Other, please specify ( )

b) Does the institution set targets for micro credit services?

Yes [ ] No [ ]

If yes, how does monitoring of these targets compare with monitoring of targets of other types of services?

- Favourably comparable ( )
- There is lower emphasis on targets than the other products. ( )
- Any other, Specify ( )

c) Does the micro credit department have specific credit officers?

Yes [ ] No [ ]

d) How are your micro credit activities organized? (Tick as appropriate)

- Within a separate department ( )
- A unit within a department ( )
- Any other, specify ( )

g) Which, among the following, factors do you consider in establishing a credit control policy? Please tick appropriately.

	Least considered			Most considered	
	1	2	3	4	5
• Existing credit policy	( )	( )	( )	( )	( )
• Overhead costs	( )	( )	( )	( )	( )
• General trend of credit extended to					

your organization	( )	( )	( )	( )	( )
• The state of the economy	( )	( )	( )	( )	( )
• Any other, specify	( )	( )	( )	( )	( )

h) Tick below the people who formulate your credit policy.

	Least formulate			Most formulate	
	1	2	3	4	5
• Executive management	( )	( )	( )	( )	( )
• Employee suggestions	( )	( )	( )	( )	( )
• Board of directors	( )	( )	( )	( )	( )
• Credit manager	( )	( )	( )	( )	( )
• Credit analyst	( )	( )	( )	( )	( )
• Credit committee	( )	( )	( )	( )	( )
• Any other, specify........................	( )	( )	( )	( )	( )

i) How regularly do you review your credit policy?

- Quarterly ( )
- Half yearly ( )
- Yearly ( )
- Others, specify ( )

4. Credit Risk Management process

(a) i) How subjective or objective is your credit appraisal process?

( ) Very subjective ( ) Very objective

ii) Through what way do you make your employees aware of credit risk?

	Method Least used			Method Most used	
	1	2	3	4	5
• Regular meetings.	( )	( )	( )	( )	( )
• Regular training	( )	( )	( )	( )	( )
• Using supervision on one to one basis	( )	( )	( )	( )	( )
• Credit manual	( )	( )	( )	( )	( )

- Any other, specify............................ ( ) ( ) ( ) ( ) ( )

b) Which aspects, among the following, do you consider before availing credit? Tick appropriately

	Least considered			Most considered	
	1	2	3	4	5
i) **Character of borrower:** *(Customer willingness to repay, past repayment experience, high credit discipline, past performance in repayment)*	( )	( )	( )	( )	( )
ii) **Capacity/completion**: *(Cash in bank, projected cash earnings, business skills)*	( )	( )	( )	( )	( )
iii) **Conditions:** *(Poor economic conditions, high credit discipline, interest prevailing in the economy)*	( )	( )	( )	( )	( )
iv) **Collateral /security:** *(Assets, capital invested in the business, size of security, cash in the bank)*	( )	( )	( )	( )	( )
v) **Common sense/reasonableness:** *(Reasonableness of cash flow; projected cash flow)*	( )	( )	( )	( )	( )
vi) **Contribution** *(Assets, Capital invested in the business and willingness to do business correctly)*	( )	( )	( )	( )	( )

c) i) Who are involved in credit risk assessment in your organization?

	Least involved			Most involved	
	1	2	3	4	5
• Chairman	( )	( )	( )	( )	( )
• Managing director/General Manager	( )	( )	( )	( )	( )
• Branch manager	( )	( )	( )	( )	( )
• Credit Manager/Head of credit	( )	( )	( )	( )	( )
• Credit committee	( )	( )	( )	( )	( )
• Any other, specify.......................	( )	( )	( )	( )	( )

ii) Who approves the amount of credit or loan given to a client? Tick appropriately.

Amount scale	Approving authority		
• Upto 500,000	Managing Director ( )	Credit Manager ( )	Branch Manager ( )
• 500,000-1M	Managing Director ( )	Credit Manager ( )	Branch Manager ( )
• 1M - 1.5M	Managing Director ( )	Credit Manager ( )	Branch Manager ( )
• 1.5M - 2M	Managing Director ( )	Credit Manager ( )	Branch Manager ( )
• Over 2M	Managing Director ( )	Credit Manager ( )	Branch Manager ( )

d) When does your institution decide that a client has defaulted on loan repayment?

	Least			Most	
	1	2	3	4	5
• One late payment	( )	( )	( )	( )	( )
• Two late payments	( )	( )	( )	( )	( )
• Three late payment	( )	( )	( )	( )	( )
• Four late payment	( )	( )	( )	( )	( )
• Five late payment	( )	( )	( )	( )	( )
• Any other, specify...................	( )	( )	( )	( )	( )

e) How does the institution deal with 'difficult-to-repay-on-time' clients?

	Least done			Most done	
	1	2	3	4	5
• Use auctioneers to recover the debt	( )	( )	( )	( )	( )
• Sale of their properly to recover the money	( )	( )	( )	( )	( )
• Leave them alone to decide when to pay	( )	( )	( )	( )	( )
• Write the debt off and account it as bad Debts	( )	( )	( )	( )	( )
• Write off interest and allow them to pay the principal	( )	( )	( )	( )	( )
• Any other, specify....................................	( )	( )	( )	( )	( )

f) How important are the risks listed below to your institution?

	Least important			Most important	
	1	2	3	4	5
• Foreign exchange risks	( )	( )	( )	( )	( )
• Technology risks	( )	( )	( )	( )	( )
• Interest rate risks	( )	( )	( )	( )	( )
• Market risks	( )	( )	( )	( )	( )
• Liquidity risks	( )	( )	( )	( )	( )
• Credit risk	( )	( )	( )	( )	( )
• Any other specify	( )	( )	( )	( )	( )

g) Which of the following methods do you use against these risks?

	Least used			Most used	
	1	2	3	4	5
• Futures	( )	( )	( )	( )	( )
• Forwards	( )	( )	( )	( )	( )
• Swaps	( )	( )	( )	( )	( )
• Options	( )	( )	( )	( )	( )
• Any other options	( )	( )	( )	( )	( )

5. **Organizational Performance**

What factors have impacted on financial performance of your institutions in the last five years (2001 – 2005)?

	Least considered			Most considered	
	1	2	3	4	5
• Improved loan collection methods	( )	( )	( )	( )	( )
• Customer not willing to repay loan	( )	( )	( )	( )	( )
• Charged too high interest rate	( )	( )	( )	( )	( )
• Poor economic conditions	( )	( )	( )	( )	( )
• Improved credit appraisal	( )	( )	( )	( )	( )

- Any other, specify ( ) ( ) ( ) ( ) ( )

6. **Strategic Management factors**

a) Does your institution have a long-term strategy to maintain micro credit activities? (Please tick where appropriate).

Yes [ ] No [ ]

b) Please indicate the source of funds used for micro credit activities.

- Internally generated funds
- Customer savings
- Donor funds

....

THANK YOU FOR YOUR TIME