THE ROLE OF CREDIT RISK MANAGEMENT IN MICRO FINANCE INSTITUTIONS IN GHANA – A CASE STUDY OF ST. PETER'S CREDIT UNION

By

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DEDICATION

This work is dedicated to my children, Ram-jyotir, Sita and Saraswati, and also to my husband, Mr. Kofi Ampong. Thanks for all your support.

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DECLARATION

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

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ABSTRACT

Micro financial institutions play an important role in the Nations development by making loans available to small and medium scale enterprises who do not qualify for loans from the traditional banks, due to their high risk nature. However, these institutions are exposed to various types of risks in pursuit of their business objectives, and failure to adequately manage these risks may threaten their survival as business entities. This research looks at the various risk management policies adopted by micro financial institutions in managing risks encountered during their operations. It also assesses the impact of such policies on the beneficiaries of credit as well as the extent to which these policies help the financial institutions achieve their objectives. St. Peter's Credit union was used as a case study for this research. Both primary and secondary data were used .The primary data was sourced through questionnaires and interviews and the secondary data, through books, journals and other relevant materials. The sample population was made up of the Credit Union's risk management officer and their customers. Results from this research revealed that credit risk management practices have reduced the high credit risk that Micro Finance Institutions encounter during their operations, to a manageable level resulting in increased profit levels. Secondly, the establishment of Micro Finance Institutions has really helped to improve the living standards of it's beneficiaries. This was noticed in the standard of living of the clients as well as their ability to acquire properties and expand their businesses. The study also revealed that Risk Managers should try to keep adequate liquidity levels due to future uncertainties within the financial sector.

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1.0 INTRODUCTION

The banking industry has gone through many changes as a result of the introduction of Information Communication Technology (ICT). The industry has introduced various new customer services and products using Information communications technology. In fact, the structure of the industry is continuously changing because of the rapid development of Information communications technology. Information technology has tremendously stimulated expansion of the banking networks and range of services offered during recent years.

With developments in Information communications technology, more banks introduced these services for their customers, making them standard activities. Technological progress has enabled deregulation of the banking sector, removing barriers in intrastate and interstate banking and branching, granting them more flexibility in terms of introducing new services, which predominantly took place in the 1980s and 1990s. Although every banking operation requires some Information communications technology applications, researches vary on the subject of the relationship between the level of employed hardware and software, and the value of the banking efficiency increase. All researchers agree on the importance of Information communications technology for the further developments of the banking industry, but some of them have found lack of proportionality between the increase in the scale of Information communications technology utilization and the increase in banks profitability (Thakor, 1999; Olazabal, 2002).

Information Technology developments affect operations of banking organizations in at least four different ways:

(1) Information Technology enables banks to start new depositary services, such as call centers, ATMs, and Internet banking, which give more opportunities to achieve economies of scale, and fewer diseconomies, rather than the same depository services provided through traditional branching networks (Radecki, Wenninger, and Orlow, 1996). In similar way, some wholesale Information Technology-driven products, such as securitization, derivatives, and other off-balance activities are more efficiently provided by large banks, constituting their dominance in the markets of these products.

(2) Technological progress causes innovations in producing new banking services that are subject to greater scale economies or fewer diseconomies than the existing technologies, these innovations are particularly important for electronic payments and credit scoring services.

(3) Advances in Information Technology allow large banks to control investment risks more efficiently than small banks. Well equipped Information Technology credit risk departments of large banks are able to make riskier, but with highly-expected returns on investments, improve access to uninsured funding, and save on costly equity capital.

(4) Another advantage of the Information Technology progress may come from reduction of managerial diseconomies of scale. Information Technology advances improves monitoring and control within large banks better than within small banks. These technologies may make it easier for managers of large, multi-branch banks to monitor the behavior of their staff, reducing agency problems. Some research based on data from the early and mid-1990s suggest existence of substantial scale efficiency gains from larger sizes and that these economies may have continued increasing during the next years (Berger and Mester, 1997, and Stiroh, 2000). Developments in Information Technology may also facilitate improvements of revenue efficiencies. Efficient information and telecommunication devices allowed banks to facilitate mergers and acquisitions,

CHAPTER ONE

1.0 INTRODUCTION

In organizations almost every decision has an upside and a downside involving some degree of risk. Financial institutions are exposed to various types of risks in pursuit of their business objectives. The basic ones include credit, market, liquidity, and operational risks.

Risk can be defined as "any event or action that may adversely affect an organization's ability to achieve its objectives and execute its strategies" or, alternatively, "the quantifiable likelihood of loss or less-than-expected returns" (McNeil et al, 2005). Failure to adequately manage these risks exposes the financial institutions not only to losses, but may also threaten their survival as business entities thereby endangering the stability of the financial system.

Risk management is a structured approach to managing uncertainty through, risk assessment, developing strategies to manage it, and mitigation of risk using managerial resources. According to Wikipedia – online resource, the objective of risk management is to reduce different risks related to a preselected domain to the level accepted by society. It is a proactive approach, which makes future decisions in the present about what will happen in the future rather than a reactive approach where you wait for the occurrence of an activity before one finds solutions for them.

To most, microfinance means providing very poor families with very small loans (microcredit) to help them engage in productive activities or grow their tiny businesses (http://www.microfinance.com). Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

Many Micro financial Institutions handle these risks associated with giving credit to the poor on a daily basis, in order to grow and encounter rapid changes. Therefore, risks must be understood and carefully managed for a proper decision.

Effective risk management can bring far-reaching benefits to all organizations, whether large and small, public or private sector.

This research seeks to find out the role of credit risk management in the Micro financial sector in Ghana.

1. 1 PROBLEM STATEMENT

Micro finance Institutions (MFIs), known as the bank for the poor, make funds accessible to the small and medium scale enterprises who do not qualify for loans from the traditional banks due to their high risk nature. If Micro finance institutions are taking up this high credit risk responsibility, how do they manage the high credit risk they are exposed to in order to make profit and stay in business? What credit risk policies are adopted to reduce the credit risks they are exposed to and the impact of the credit risk policies on their clients? From the above one may ask the following questions.

1.2 RESEARCH QUESTIONS

- What policies are put in place to reduce credit defaults as well as to encourage the poor to access fund?
- Are there any relationships between the risk management and the growth of Micro financial institutions in Ghana?
- Does risk management have an impact on risky shift through reduction of bad loans in the Micro financial system?

1.3 OBJECTIVES

The objectives of this research are as follows:

- To investigate the impact of credit risk management on Micro finance institutions' profitability.
- To assess the impact of risk management practices on the clients of Micro finance institutions.
- To find out how credit risk is measured in Micro finance institutions.
- To make recommendations to address issues on credit risk management in Micro Finance Institutions.

1.4 SCOPE

This research seeks to study the various policies on credit risk management adopted by St. Peter's Catholic Credit Union and the impact of these policies on their clients. The research also looks at how these policies help the organization achieve its goals as a micro finance institution.

1.5 OVERVIEW OF METHODOLOGY

Both primary and secondary data was used .The primary data was sourced through questionnaires and interviews and the secondary data, through books, journals and other relevant published materials.

The sample population was made up of the Credit Union's risk management officer and their customers. The sample size chosen for the study was hundred (100) customers and the credit risk officer. Customer samples were selected through non probability convenience sampling within the 70 kilometer radius of operation, of the organization. Primary data collection was through the administering of questionnaires and interviews.

1.6 JUSTIFICATION

Micro financial institutions play an important role in the Nations development by making loans available to small and medium scale enterprises who do not qualify for loans from the traditional banks, due to their high risk nature. However, these institutions are exposed to various types of risks in pursuit of their business objectives, and failure to adequately manage these risks may threaten their survival as business entities. This research looks at the various risk management policies adopted by micro financial institutions in managing risks encountered during their operations. It also assesses the impact of such policies on the beneficiaries of such loans as well as the extent to which these policies help the financial institutions achieve their objectives. The outcome of this research would help advice micro financial institutions on the effectiveness of their risk management policies.

1.7 LIMITATIONS

Micro finance Institutions deal mostly with the Small and Medium scale Enterprises (SMEs), and these SMEs are characterized with high illiteracy rate. Thus, this research encountered some attitudinal problems on the part of the Credit Union customers to give credible information.

Micro financial institutions also have a policy of safe guarding information, especially those that will have an adverse effect on the organization. This could also give an erroneous impression of their situation.

Embarking on frequent visits to the Credit Union, as well as going round to interview beneficiaries of the loans put some financial burden on this research.

1.8 ORGANIZATION OF THE STUDY

This thesis is divided into five chapters.

Chapter one deals with the general introduction to the study, problem statement, objectives, scope of study, methodology, justification and limitations associated with the research.

In Chapter two, looks at the literature review, definition of micro finance in general, micro finance in Ghana, type of micro financial institution and their associated functions. It also examines questions like what is risk, what are credit risk and the role of risk management.

Chapter three also deals with the detailed methodology, background information on the micro financial institution chosen as a case study for this research work: St Peters Credit Union, the credit risks encountered during their operations and their credit risk management policies.

Chapter four highlights on findings from the case studied and analysis. Qualitative analysis was used to asses the impact of Credit Risk Management on their recovery of loans and assessing the impact of credit risk policies on the Micro credit clients. Quantitative analysis was used in investigating the impact of Credit risk management on the profitability of the Micro Finance Institution.

Chapter five highlights on summary of the findings, recommendations and conclusion.

CHAPTER 2

2. LITERATURE REVIEW

The research was concerned with examining all the relevant theories that suggest the possibility of the existence of a relationship between risk management and the risk reduction strategy of Micro financial institutions in Ghana. A wide variety of academic materials, were studied to gain a better understanding of the core issues involved in this research.

2.1 A GENERAL UNDERSTANDING OF THE CONCEPT OF MICRO FINANCIAL INSTITUTIONS

2.1.1 Definition of Micro financial Institution

Microfinance is defined as: a credit methodology that employs effective collateral substitutes to deliver and recover short-term, working capital loans to micro entrepreneurs (CGAP, 2003).

According to Manalo 2003, Microfinance programs extend financial services ranging broadly across savings, loans, payment services, money transfers, and insurance to enterprises generally owned by poor and low income households: a group long thought not to have the ability to save nor to utilize credit productively and repay loans at non-subsidized interest rates.

Micro Finance sometimes called "banking for the poor" is an amazingly simple approach that has been proven to empower very poor people around the world to pull themselves out of poverty. Relying on their traditional skills and entrepreneurial instincts, very poor people, mostly women, use small loans, other financial services, and support from local organizations called microfinance institutions (MFIs) to start, establish, sustain, or expand very small, self-supporting businesses. A key to microfinance is the recycling of loan. As each loan is repaid, usually within six months to a year, the money is recycled as another loan. Thus, multiplying the value of each dollar in defeating poverty, and changing lives and communities. The local MFI might also offer microfinance in addition to activities such as, entrepreneurial and life skills training, and advice on topics such as health and nutrition, sanitation, improving living conditions, and the importance of educating children. MFI's are funded by individuals, philanthropists, foundations, Governments and international institutions such as the World Bank. MFI's also borrow funds from traditional banks to loan to their clients. In addition, the interest paid by clients on microfinance loans goes back into the program to cover costs and fund more loans.

Although experiments on Micro credit started in Bangladesh, Brazil and a few countries in the 1950s, it became prominent in the 1980s. The important difference introduced by microcredit was that, it avoided the pitfalls of an earlier generation of targeted development lending by insisting on repayment, and charging interest rates that could cover the costs of credit delivery, and by focusing on client groups whose alternative source of credit was the informal sector. Emphasis shifted from rapid disbursement of subsidized loans to prop up targeted sectors towards the building up of local, sustainable institutions to serve the poor.

Microcredit has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending.

Traditionally, microfinance was focused on providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance. Our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products. (http://www.microfinancegateway.com)

2.2 TYPES OF MICRO FINANCIAL INSTITUTIONS AND THEIR ASSOCIATED FUNCTIONS

A microfinance institution is an organization that offers financial services to low income populations. Almost all of these offer microcredit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services: NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks.

2.2.1 Financial Non Governmental Organizations (FNGO's)

FNGO's are fully and virtually exclusively dedicated to offering financial services; in most cases microcredit. FNGO's are not allowed to capture savings deposits from the general public. These groups of a few hundred FNGOs have led the development of microcredit, and subsequently microfinance all over the world. Most of these constitute a group that is commonly referred to as "best practice" organizations; ones that employ the newest lending techniques to generate efficient outreach that permit them to reach down far into poor sectors of the economy on a sustainable basis.
A great many of FNGOs that offer microcredit, perhaps even a majority, engage in other non-financial development activities and would bristle at the suggestion that they are essentially financial institutions. However, from an industrial perspective, since they are engaged in supplying financial services to the poor, they are referred to as MFIs.

2.2.2 Commercial Banks

Commercial banks also offer microfinance services. For this purpose they are referred to as MFIs, even though only a small portion of their assets may actually be tied up in financial services for the poor. In both cases, when people in the industry refer to MFIs, they are referring only to that part of the institution that offers microfinance (Microfinance Gateway 2003).

2.2.3 Credit Unions and Cooperative Housing Societies

These are institutions who consider themselves to be in the business of microfinance and they play a role in reshaping and deepening the financial sector. These are community-based financial intermediaries. Some are membership based and others are owned and managed by local entrepreneurs or municipalities. These institutions tend to have a broader client base than the FNGOs .Their operations vary from country to country, and many poor people do have some access to these types of institutions, although they tend not to reach down market as far as the financial NGOs. (Microfinance Gateway 2003)

2.3 MICRO FINANCE IN GHANA

This section looks at concrete examples of the above-mentioned type of Micro financial institutions in Ghana and how they function, the basis on which the business is carried out and the legal framework of finance regulations in Ghana

In Ghana Microfinance services are provided by three types of sources: formal institutions, such as rural banks and cooperatives; semiformal institutions, such as nongovernmental organizations; and informal sources such as money lenders, credit unions and susu collectors.

The formal sectors are those that are incorporated under the Companies Code 1963 (Act 179), which gives them legal identities as limited liability status, and subsequently licensed by the Bank of Ghana (BOG) under either the Banking Law 1989

(PNDCL 225) or the Financial Institutions (Non-Banking) Law 1993 (PNDCL 328) to provide financial services under Bank of Ghana regulation.(F. Steel and O. Andah 2003)

Most of the banks target urban middle income and high net worth clients. Rural and Community Banks (RCBs) operate as commercial banks under the Banking Law, except that they cannot undertake foreign exchange operations, their clientele is drawn from their local catchment's area, and their minimum capital requirement is significantly lower. Financial institutions providing microfinance services consist of Rural Banks, Savings and Loan (S&L) companies and other commercial financial institutional.

The semi formal sector consist of a number of FNGOs and Credit Unions, organized by private parties as trust entities or charitable institutions under the provisions of the Law on Trusts and Charitable Institutions, provide both micro loans and non financial services to their client-base, without being subject to regulation or supervision by external government agencies. The majority of micro credit NGOs belongs to an umbrella organization -Ghana Micro Finance Network (GHAMFIN 2003)

The informal sector covers a range of activities known as susu, including individual savings collectors, rotating savings and credit associations, and savings and credit "clubs" run by an operator. It also includes moneylenders, trade creditors, and self help groups, and personal loans from friends and relatives. Moneylenders are supposed to be licensed by the police under Moneylenders Ordinance 1957.

The commercial banking system, which is dominated by a few major banks (among the Traders, input-suppliers, money-lenders, rotating savings and credit associations (ROSCAs), and Accumulating Savings and Credit Associations (ASCAs) constitute the informal segment of the market for microfinance in Ghana. (F. Steel and Andah 2003)

2.3.1 Legal and Regulatory Framework for Microfinance in Ghana

2.3.1.1 The Legal Structure and Judicial System.

With the exception of susu collectors, susu clubs, Rotating Savings and Credit Associations (ROSCA) and Accumulating Savings and Credit Associations (ASCA), MFIs in Ghana are required to establish legal entity. Banks and Non Banking Financial Institutions (NBFIs) which include rural banks and Savings and Loan companies (S & L) are required to be incorporated entities under the Companies Act. Credit unions have legal status and identity through registration under the Cooperative Societies Act as well as the requirements of the NBFI Law. NGOs, including those with micro credit orientation, have legal status through establishment under the provisions of the Law on Trusts and Charitable Institutions and the required registration with the Ministry of Employment and Social Welfare.

2.3.1.2 The Regulatory Framework.

In Ghana, a tiered structure of institutions and graduated regulation for microfinance existed long before the Government of Ghana gave formal recognition to microfinance in 1999, through the new Bank of Ghana (BOG) regulations pertaining specifically to microfinance. The newly-adopted formal policies on microfinance and the adoption of a regulatory framework specific to microfinance activities had parallel co-existence with an existing credit-quota system for agricultural credit and SME finance. The regulatory (and tax) preferences enjoyed by rural banks and credit unions in combination with the operation of a graduated/tiered system have made it possible for Financial Non Governmental Micro Finance Institutions, to transform into licensed institutions.

2.3.2 Types of Micro Finance Institutions in Ghana

2.3.2.1 Rural and Community Banks

The Rural and Community Banks are unit banks owned by members of the rural community through purchase of shares and are licensed to provide financial intermediation in the rural areas. Rural Banks (RBs) were first initiated in 1976 to expand savings mobilization and credit services in rural areas not served by commercial and development banks. Investment in a productive asset, it tended to result in portfolio performance problems, as borrowers had difficulty making balloon payments because Rural Banks (RBs) had weak capacity to follow up and enforce repayment. During the 1990s, however, a number of the more progressive Rural Commercial Banks (RCBs) drew on emerging microfinance techniques to introduce new programs for saving and credit, often in association with NGOs that could provide the expertise in implementing the approach. Loans of this type are generally short-term (4-6 months) with weekly repayment, averaging around $50-75 but ranging up to several hundred dollars, with compulsory up-front savings of 20% that is retained as security against the loan, complementing group or individual guarantees as the other principal form of security.

2.3.2.2 Savings and loans

The Savings and Loans (S&L) category has also made possible the entry of private investors to serve a particular market niche on a smaller scale than would be required for a commercial bank.

The S&Ls generally use the loan products under Rural Commercial Banks (RCBs). For example, First Allied Savings and Loans uses a group and individual savings with credit scheme with existing, registered occupation-based groups such as butchers, kente weavers, carpenters, and other associations (Chord, 2000).

Savings and Loans have also been leaders in innovation. Citi Savings and Loans uses *Susu* Clubs or any other economic association for their group loan product, with joint group guarantee and savings mounted up to 50% of loan amount. It has pioneered linkages with *susu* collectors as well as clubs, including other forms of individual loan products. Citi also has a micro-leasing product available to clients with at least two successful loan terms.

2.3.2.3 Credit Unions

Credit Unions are thrift societies offering savings and loan facilities exclusively to members. The first credit union in Africa was established at Jirapa in the Northern Region (now Upper West) in 1955 by Canadian Catholic missionaries. The Credit Union Association, is a private association of cooperative societies, independent of the government. Individual members make predetermined periodic deposits into their accounts and may borrow a maximum of twice their savings balance. Most Credit Unions require borrowers to provide security, in addition to being in good standing with their deposits.

Ideally, this can be in the form of a guarantee from another member of the credit union who has adequate uncommitted savings balance. Some Credit Unions use the *susu* method in the collection of deposits and loan repayments. The Credit Union Association is an innovator in providing both credit insurance (which pays off the outstanding loan balance in case of the death of a borrower) and a contractual savings program (which matches savings, up to a limit, if held at death or to maturity) (Gallardo et al. 2002).

2.3.2.4 Non-Governmental and Community-Based Organizations

Non Governmental Organizations (NGOs) and Community-based Organizations (CBOs) make financial services available in the northern part of the country, where both commercial and rural banks are scarce. Although NGOs tend to be somewhat localized and dependent on donor funds, their operations go a long way in alleviating poverty among the rural dwellers.

Non Governmental Organizations (NGOs) have facilitated the development of good microfinance practices in Ghana by introducing internationally tested methodologies, often in partnership with Rural Micro Finance Institutions. The methodologies introduced by these NGOs often are based on group solidarity methods, and have benefited from linkages with CBOs that have already "come together on the basis of some kind of location, occupations, friendship, family ties, gender, or other grounds to serve a purpose at the community level (Chord, 2000).

2.3.2.5 Susu Collectors, Associations, Clubs, Companies

The *susu* system primarily offers savings products to help clients accumulate their own savings over periods ranging from one month to two years. Members of a Rotating Susu Collectors Association (ROSCA), usually take turns to receive their lump sum. Some *susu* club operators try to attract more clients by advancing members' target savings amount well before the end of the cycle.

Susu collectors give occasional advances to their best customers before the end of the month, and in some cases may give loans for a period of three months, although their ability to carry out such a gesture, is constrained by the fact that they generally lack capital apart from the savings they mobilize. In an effort to capitalize on *susu* collectors' intimate knowledge of their clients, several Rural Commercial Banks and Savings and Loans Schemes, have participated in a pilot program to provide funds to *susu* collectors for them to lend to their clients.

2.4 PROCEDURES FOR ACCESSING MICRO FINANCE

There are four types of Group and Individual Savings and Credit Programs.

- **Group savings with credit**: A group of members (whether pre-existing or formed for this purpose) open a joint bank savings account and mobilize initial savings deposits to qualify for a loan. Group savings may be used as security against loans, and are also used to invest in Treasury bills for the group. Groups are usually made up of 3 to 4 sub-solidarity groups.

- **Group and individual savings with credit**: Group members contribute to both a joint group account and their individual accounts. The group may be a "village bank" of between 25 and 40 members, or could be as small as 5 members. While both individual and group savings accounts are used as collateral, the individual account includes the member's additional personal savings. Loan repayments are made by individuals but handled through the group account.

- **Individual savings with group credit**: Individuals lodge their savings through the group, which receives a loan for distribution to members after a qualifying period and collection of the required level of savings. They continue to save into their individual accounts as they repay the loan. The group handles the collection of savings and repayments, acts as the interface with the loan officer, and bears group responsibility for recovery (though the loans are made to individual members)

- **Individual savings with credit**: This involves direct lending to individuals, either those who had established a credible history as a member of a group but who need larger or separate loans, or in cases where a group approach is not suitable. Examples: Lower Pra Rural Bbank; Nsoatreman Rural Bank's District Assembly Poverty Alleviation Program (Steel and Andah, 2003).

Micro Finance Institutions, are exposed to various risks in pursuit of their business objectives, the basic ones include credit, market, liquidity, and operational risks. Failure to adequately manage these risks exposes MFIs not only to losses, but may also threaten their survival as business entities thereby endangering the stability of the financial system..

2.5 NATURE OF RISK

According to McNeil et al, risks are any event or action that may adversely affect an organization's ability to achieve its objectives and execute its strategies" or, alternatively, "the quantifiable likelihood of loss or less-than-expected returns". Risk is the uncertainty that the future holds.

The Concise Oxford English Dictionary defines risk as "hazard, a chance of bad consequences, loss or exposure to mischance"

According to Diacon, 1988, risks are present whenever human beings are unable to control or perfectly foresee the future. For example, risk of theft, fire, and natural disasters. Similarly, there are risks in running a business, because no business man can guarantee that he will make profits rather than losses.

2.5.1 Types of Risk

Fundamental and particular risks: Fundamental risks affects either society in general or people and cannot be controlled (in partially) by any one person, whereas particular risks refers to those future outcome that we can control partially (though not predictably) (Diacon, 1988).

Pure and speculative risks: Speculative risks are present if either beneficial or adverse outcomes could stem from a specific event, whereas if possible harm is the only alternative to the present status quo, the situation is known as pure risk.

Uninsurable risks: In practice, not all risks can be insured. The insurability of risks depends on a number of factors which are:

- Measurable in money terms

- Pure risks only

- A large number of independent exposures

- Fortuitous losses or accidental losses (Diacon and Carter, 1988).

2.5.2 Forms of Risks Encountered In The Financial Sector

Since financial institutions deal with the money market, they have to be liquid at any point in time in order to cover their debt in the short term. The following are risks that financial institution may encounter.

2.5.3 Liquidity Risks

Also called bankruptcy risks, is the risk arising from a situation where a firm may be unable to repay depositors therefore leading to insolvency or default.

2.5.4 Credit Risks

This is the most common type of risk faced by financial institutions in the money market. It is the risk that an issuer of debt securities or a borrower may default on his obligations or that the payment of the interest or the principal or both may not be made on a negotiable instrument

2.5.5 Inflation or Price Risks

This is the risk that arises when the values of a portfolio (security) will decline in the future, or a type of mortgage pipeline risk, created in the product segment when loan terms are set for the borrower in advance of terms being set for secondary market sale. If the general level of rate rises during the product cycle, a lender may have to sell his original loan at discount and this could lead to a loss.

For Micro Financial Institutions to achieve their institutions objectives, these risk need to be managed.

2.6 RISK MANAGEMENT

According to McNeil, 1990, risk management is a discipline for living with the possibility that future events may cause adverse effects. A bank actively and willingly takes on risk, because it seeks a return and this does not come without risk. Indeed risk management can be seen as the core competence of a bank. By using its expertise, market position and capital structure, a financial institution can manage risks by repackaging them and transferring them to markets in customized ways.

Risk management introduces the modern theory of planning or decision making under uncertainty, that is, contingency planning (Schwartz, 2001). Managers in the past have always used financial ratios in quantifying risks. Decision making involves, making decision now about what will happen in the future. In this light, decisions in the future may turnout to have a negative effect on actual result or vice-versa or actual results can be very different from expected results. Risk management is therefore concerned with the identification of potential problems and eliminating or reducing the damage which they may result in if the problem materializes.

The objectives of risk management is an efficient planning for risks and this therefore formally addresses the identification, which may alter the implementation of company's policy(ies), towards achievement of company objectives. Risk management is a proactive approach rather than a reactive approach.

Managing the risk is thus related to preserving the flow of profit and to techniques like

Asset Liability Management (ALM),which might be defined as managing a financial institution so as to earn an adequate return on funds invested, and to maintain a comfortable surplus of assets beyond liabilities.

2.6.1 The Role of Risk Management

Risk management is a staff function; in a management environment it helps an organization in the following ways:

a) It identifies, captures, processes and communicates risks management information to management concerning the operation of the organization.

b) It helps to analyze the nature of the cost associated with the management of risks.

c) It affords the management team the opportunity to achieve its objectives as planned. In a company environment where risks management is absent, management plans are disrupted by the occurrence of some unseen events.

d) It disposes management of all situations of risks which may prevent a company of achieving its objectives

e) It is therefore presented with careful planning, arranging and controlling of operations and resources in order to minimize the impact of risks.

2.6.2 Steps involved in the Risk Management Process

1. **Identification** of risk in a selected domain of interest
2. **Planning** the remainder of the process.
3. **Mapping out** the following:
    - the social scope of risk management
    - the identity and objectives of stakeholders
    - the basis upon which risks will be evaluated, constraints.
4. **Defining a framework** for the activity and an agenda for identification.
5. **Developing an analysis** of risks involved in the process.
6. **Mitigation** of risks using available technological, human and organizational resources.(www.Wikipedia.com)

For the purpose of this research the focus is on Credit Risk Management (CRM) on loans

2.7 WHAT IS CREDIT RISK

According to McNeil et al, 1990, **Credit risk** is the risk of not receiving promised repayments on outstanding investments such as loans and bonds, because of the "default" of the borrower.

2.7.1 Theories of Credit Risk

According to Long, (1989), the origin of financial distress can be traced as far back as the 1950s and 1960s when developing countries decided to invest in foreign countries.' Financial institutions, mostly commercial banks, provided short-term command trade credits. However, they were faced with directed credit programs by the governments. These were said to borrow very huge sums thereby increasing the bank's risk concentration. Thus they were forced to become insolvent or actually fell.

The first Basel Accord of 1988 on Banking Supervision (Basel I) took an important step towards an international minimum capital standard. Its main emphasis was on credit risk, which by then was clearly the most important source of risk in the banking industry.

By 2001 a consultative process for a new Basel Accord (Basel II) had been initiated. The main theme was credit risk, where the aim was that banks can use a finer, more risk-sensitive approach to assessing the risk of their credit portfolios. Banks opting for a more advanced, so-called internal-ratings-based approach were allowed to use internal and/or external credit-rating systems wherever appropriate.

Before a Micro financial Institution can manage its credit risk on loans it needs to go through a risk management process. There is the need to know the quantum of the risk pervading in the institution.

2.7.2 Guidelines to the practice of credit risk management according to new Basel 2005 to be followed by financial institutions.

2.7 2. 1 Credit Origination

Financial Institutions must operate within a sound and well-defined criteria for new credits as well as the expansion of existing credits. Credit should be extended within the target markets and lending strategy of the institution.

The key feature of credit origination should be the assessment of the risk profile of the customer/transaction. Banks should develop procedures that adequately capture salient issues regarding the borrower's industry; macro economic factors; the purpose of credit; source of repayment; track record and repayment history of the borrower; repayment capacity of the borrower; the proposed terms and conditions and covenants; adequacy and enforceability of collaterals; and appropriate authorization for the borrowing.

2.7. 2.2. Credit Administration

The credit administration function is basically a back office activity that supports and controls extension and maintenance of credit. A typical credit administration unit should perform the functions of credit documentation, disbursement and monitoring; loan repayment; and maintenance of credit files, collateral and security documents. This can be known by measuring the type of risk.

2.7. 2.3. Credit Measurement

The measurement of credit risk is of vital importance in credit risk management. Financial Institutions should adopt qualitative and quantitative techniques to measure the risk inherent in their credit portfolio. To measure the credit risk, banks should:

- Establish a credit risk rating framework across all types of credit activities.
- Among other things, the rating framework should, incorporate the measurement of business risk (i.e. industry characteristics, competitive position, management, etc.), and financial risk (i.e. financial condition, profitability, capital structure, present and future cash flows, etc.).
- The credit rating framework should be designed to also serve as a tool for monitoring and controlling risk inherent in individual credits as well as in credit portfolios of a bank or a business line.
- The risk rating should categorize all credits into various classes on the basis of underlying credit quality.
- Risk ratings should be assigned at the inception of lending, and reviewed at least half-yearly.
- Banks should, however, review ratings as and when adverse events occur. A separate unit different from loan origination unit should review risk ratings.
- As part of portfolio monitoring, banks should generate reports on credit exposure by risk grades. Adequate trend analysis should also be conducted to identify any deterioration in credit quality. Banks may establish limits for risk grades to highlight concentration in particular rating bands.

It is important that the consistency and accuracy of ratings is examined periodically by a function such as a separate credit review group.(New Basel Capital Accord 2005),

2.7.2 .4 Minimizing Credit Risk

According to Heffernam (2005), there are five key ways a financial Institution (bank) can minimize credit risk: through accurate loan pricing, credit monitoring, use of collateral, loan diversification and more recently through asset securitization and or the use of credit derivatives. The weight applied on each of the methods will vary, depending on whether the loan is commercial or retail.

2.7.2.5 Managing Problem Credits

In order for financial Institutions to manage credit problems, they should ensure the following.

- Establish a system that helps identify problem loans ahead of time when there may be more options available for remedial measures.
- Once a problem loan is identified, it should be managed under a dedicated remedial process.
- Banks should clearly set out how they will manage their problem credits.
- Responsibility for such credits may be assigned to the originating business function, a specialized workout section, or a combination of the two, depending upon the size and nature of the credit and the reason for its problems.

According to Ndanusa 2009, the traditional model of assessing the performance of financial institutions has been the CAMELS Rating. CAMELS is an acronym for Capital Adequacy, Asset Quality, Management Quality, Earnings Potential, Liquidity and Sensitivity to Market Risk. While the CAMELS Rating is an excellent measure, it is believed that, it is time for the regulator to develop once and for all a reliable model for predicting bank failures in the country. This will enable the regulator closely and easily monitor the performance of the banks and take remedial actions long before things get out of hand.

CHAPTER 3

3. METHODOLOGY AND ORGANISATIONAL PROFILE

3.1 Background of St. Peter's Catholic Credit Union

St. Peter's Catholic Credit Union started in 1968 as a susu system by three Roman Catholic priests in the Upper West Region of Ghana. The aim of establishing this credit union was to help members of the congregation, in times of need. It was later introduced nationwide to all the branches of the Catholic Church. In Kumasi the credit union began at the premises of the Roman Catholic Cathedral, with a kiosk as an office.

The initial contribution to the Credit Union's fund, when it began in the Upper West Region of Ghana, was made by the three Roman Catholic priests, who were later joined by their secretary. It was later, opened up to the church members. In order to expand its operations, the union was opened to non catholic members as well. Currently the Kumasi branch of the union, which was commissioned in February 2007, is located at Bompata in the centre of Kumasi. The operational area of St. Peter's Catholic Credit Union spans a radius of 70km from its office location. Clients are given credit loans with a maximum of twice their savings.

3.1.1 Risk Encountered by the Credit Union

Though profitable, the Credit Union encounters the following risk in their operations:

- They deal with people in the informal sector (petty traders, artisans, etc)

- Their clients do not job security
- Clients do not have regular incomes.
- Lack of formal structures to facilitate client trace
- Clients giving wrong information about themselves
- Clients becomes spindrift

3.1.2 Policies put in place to manage credit risks

- Loan protection plan, clients need to take and insurance for the loan
- Loans are giving to clients in groups
- The use photographs on client forms for easy identification
- Assessing savings and repayment patterns
- The installation of a tracking system that alert overdue loan payments.

3.1.3 Product / Services offered by the Union

Some of the product or services offered by the Union include the following:

- Savings - the Union gives its clients the opportunity to open a savings account. This will enable them save their reserves, which they can depend on in times of need.

- Business Capital – business capital is offered to clients who have already established businesses and need extra capital for expansion or growth. The Union also gives business capital to its clients to enable them start new business ventures

- Provident Loans - they are loans given to clients in times of emergencies such as settling children school fees, hospital bills and funeral expenses.

- Investments – St. Peters Credit Union offers their clients the opportunity to invest in their organization by issuing shares to their clients. Before one becomes a member of the Union it is obligatory to buy at least GH¢40.00 worth of shares of the Union. This is a way to ensure that clients become committed in their dealings with the Union.

- Agricultural loans – loans are given to farmers to assist them buy equipment, seedlings, pesticides and other things needed to assist them in their farming activities.

3.2 DATA SOURCES

Data was collected from both primary and secondary sources. The secondary data formed the bulk of the data used for this research. This data was collected from the internet, books, and research publications. The primary data was collected by administering questionnaires and interviews with the credit officer as well as beneficiaries of loans from the union.

3.3 SAMPLING DESIGN

Given a research of this nature, covering the entire clients of the organization may not be possible so taking a sample to work with will be appropriate. Due to the scatted nature of clients in the Ashanti region of Ghana a purposive random sampling of about hundred clients within the 70km radius was used.

3.4 METHOD OF ANALYSIS

From the information gathered a qualitative and quantitative analysis was made. SPSS, an analytical computer software program was used in analyzing the data collected through interviews and questionnaire. The results of the data analysis were presented in the form of graphs and charts.

CHAPTER FOUR

4. DATA PRESENTATION AND ANALYSIS

The main focus of this chapter is the presentation and analysis of the data collected from the primary sources. This chapter presents the qualitative and quantitative analyses of the data collected. The analysis has been organized into two parts. The first part deals with: Assessing the impact of credit risk management policies on clients of St. Peters Credit Union. Whiles the second part looks at the clients response on how the credit union could serve them better.

4.1 ASSESSING THE IMPACT OF CREDIT RISK MANGEMENT POLICIES ON CLIENTS OF ST. PETERS CREDIT UNION

4.1.1 Gender respondents

From the data gathered, out of the sample population of hundred, ninety persons responded. Out of the respondents, forty eight were male and forty three were females. In percentage terms 52.7% of the sample size were men and 47.3 % were women. This is shown in the pie chart below.

Table 4.1.1 Gender of the respondents

Gender	Frequency	Percent	Cumulative Percent
Male	48	52.7	52.7
Female	43	47.3	100.0
Total	91	100.0	

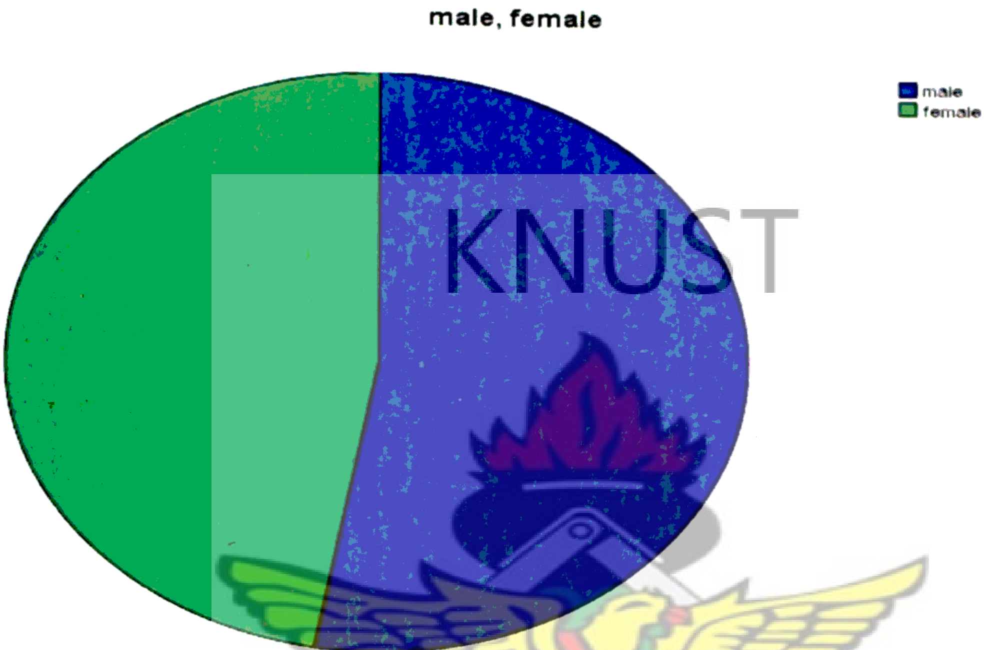


Figure 4.1.1 Gender of respondents

From the pie chart above it can be seen that more men assess credit from St. Peter's Credit Union than women. This disputes the fact that women have priority over men when it comes to assessing credit from micro finance institutions, as seen in other parts of the world.

4.1.2 Occupations of respondents

Micro finance Institutions were set up so that small and medium enterprises have assess to credit loans, an area which the normal banks would not venture into, because of the because of the high risk associated with such operations.

The occupation of the client's sampled during data collection included traders, artisan, teachers, drivers, pastors and accountants.

Trading encompasses all aspects of buying and selling. Artisans range from auto mechanics, welders, masons, auto electricians and painters. Teachers were from nursery and primary schools. Drivers were made up of mainly commercial drivers, that is, taxi and van drivers.

The denotations are as follows:

- 1 - traders
- 2 – artisans
- 3 – teachers
- 4- drivers
- 5 – students
- 6 – pastors
- 7 – accountants
- 8 – pensioners

Table 4. 1.2 Occupations of the respondents

Occupation	Frequency	Percent	Cumulative Percent
1	31	34.1	34.1
2	22	24.2	58.2
3	15	16.5	74.7
4	13	14.3	89.0
5	1	1.1	90.1
6	1	1.1	91.2
7	2	2.2	93.4
8	6	6.6	100.0
Total	91	100.0	

From the table about 72% of the clients fall within the Small and Medium scale Enterprise. This comprises of traders, artisan and drivers, 37% fall in the category of professionals and this includes, teachers, accountants and Pastors with only 1.1% being students.

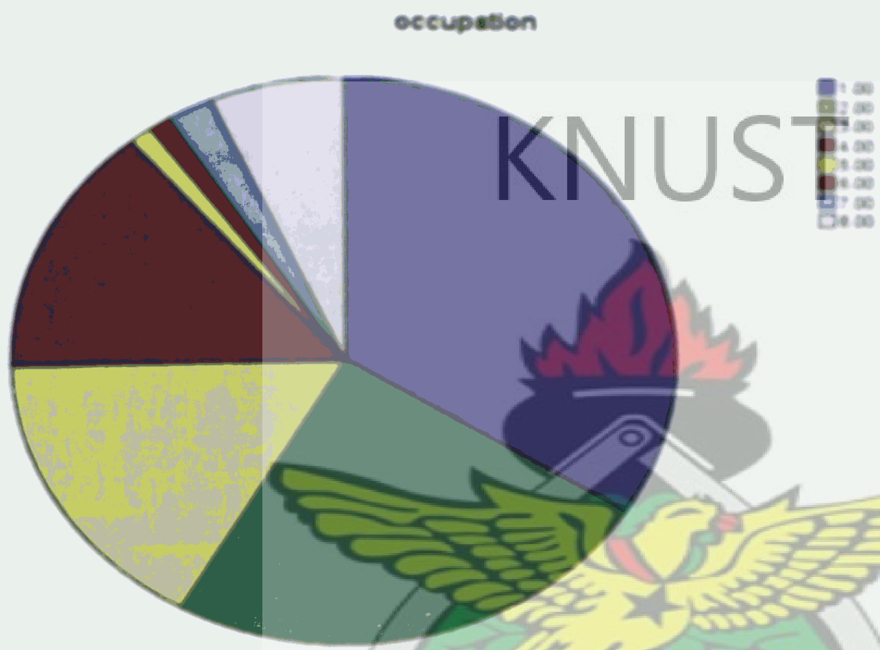


Figure 4.1.2 Occupation of the respondents

From the pie chart above it can be said that a large number of St. Peters clients are traders followed by artisans, teachers and drivers in that order. An insignificant percentage of clients are pastors, accountants, students and pensioners. A large number of the clients are traders because these credit unions provide them services they would not get in the normal banks such as:

a. Assess to small business capital with relatively lower interest rates.

b. By joining a Credit union, one becomes a member of a large welfare association which could also assist by making donations to it's members in times of need, such as during funerals, marriage etc.

c. Credit unions do not require its clients to provide collateral before assessing loans.

d. By joining a credit union one automatically becomes a share holder in the organization.

4.1.3 Benefits derived from credit assessed

Clients of the Credit Union, use the loans to acquire property, to cater for their children schooling and to improve their living standards. This is shown in the table below.

Uses of credit by clients	Frequency	Percent	Cumulative Percent
Expansion of business and build a house	34	37.4	37.4
Build a house	17	18.7	56.0
Buy a plot	7	7.7	63.7
Build a house & buy a car	10	11.0	74.7
Expand business & pay school fees	12	13.2	87.9
Buy home appliances	5	5.5	93.4
Emergencies	6	6.6	100.0
Total	91	100.0	

Table 4. 1.3 Benefits of credit enjoyed by Credit Union clients

From table 4.3, 37.4 % of the clients have used the credit to expand their business and build their own houses.18.7% have used their credit to build houses., 11% have used their credit to buy cars,13% have used their credit to pay their wards fees and expand their business. Also 5.5% have acquired some home appliance and 6.6 % have used the loans for emergencies such as funerals, court cases and to rent apartments.

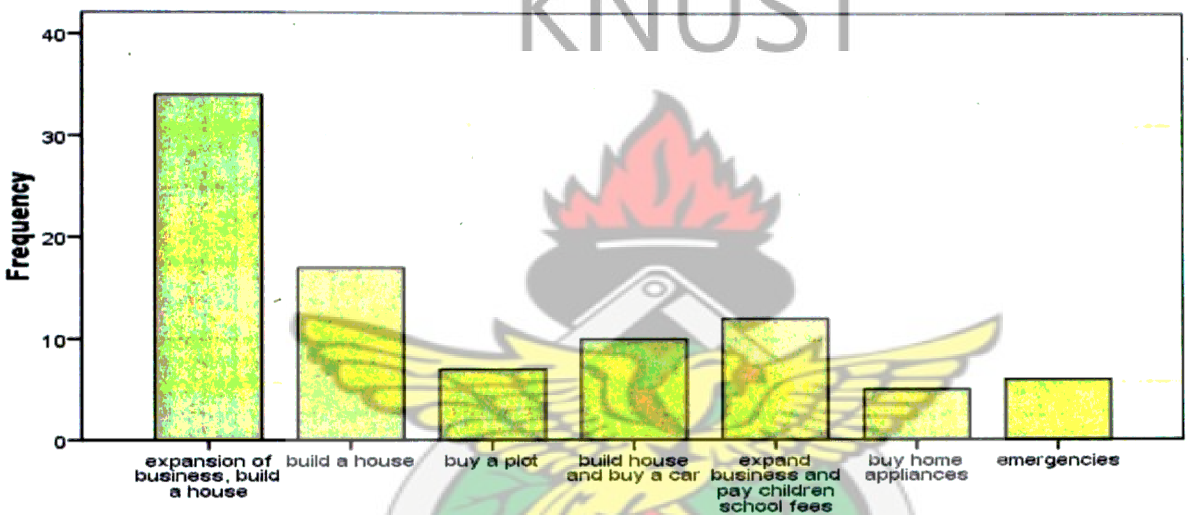


Figure 4.1.3 Uses of credit by Credit Union's clients

From the bar chart, one can see that credit assessed by clients are used to acquire property, expand their business which eventually will improve their living standard in one way or the other.

4.1.4 Challenges clients face with the credit risk management policies of St. Peter Credit Union

Before one can have access to a loan from St. Peter's Credit Union, the following conditions must be satisfied.

- One must have save with the credit union for at least six months
- One must register and paid for the credit Unions health insurance
- One must belong to a group of not less than three members
- One must hold the minimum share of forty Ghana cedis (GH¢40.00).

Table 4.1.4 challenges client have with the credit risk management policy of the Credit Union

Comments of clients	Frequency	Percent	Cumulative Percent
Clients satisfied with current conditions	35	38.5	38.5
conditions of interest rates	20	22.0	60.0
Paying for withdrawals	5	5.5	65.9
Credit Unions health insurance	22	24.2	90.1
Finding a group	9	9.9	100.0
Total	91	100.0	

From the table about 39% of the interviewed clients were satisfied with the credit policy of the Institution. These are the people who say they know the rules and adhere to them and thus, get the maximum benefit from the Union. These are the people who have achieved much with the credit assessed. Some have established firm business with branches; others have fleet of cars ranging from articulator trucks to taxis. They say the establishment of Micro finance Institutions have come to help small business.

About 22% of interviewed clients have problem with interest rates going up when repayment are not made in the stipulated time. This increases the mount to be repaid. This discourages assessing loans because once the loan is taking one never finish paying up the loan.

Also 24.2% of the interviewed clients do not feel comfortable with registering and paying for the Credit Unions health insurance. This is because; clients have already registered with the national health insurance scheme which covers most diseases including chronic diseases. However, the Credit Unions health insurance does not cover chronic diseases.

About 9% of interviewed clients have problems with finding a credit worthy group and 5% Of clients interviewed, were not comfortable with the fees charged on withdrawals. The above information is clearly shown in a bar chart below.

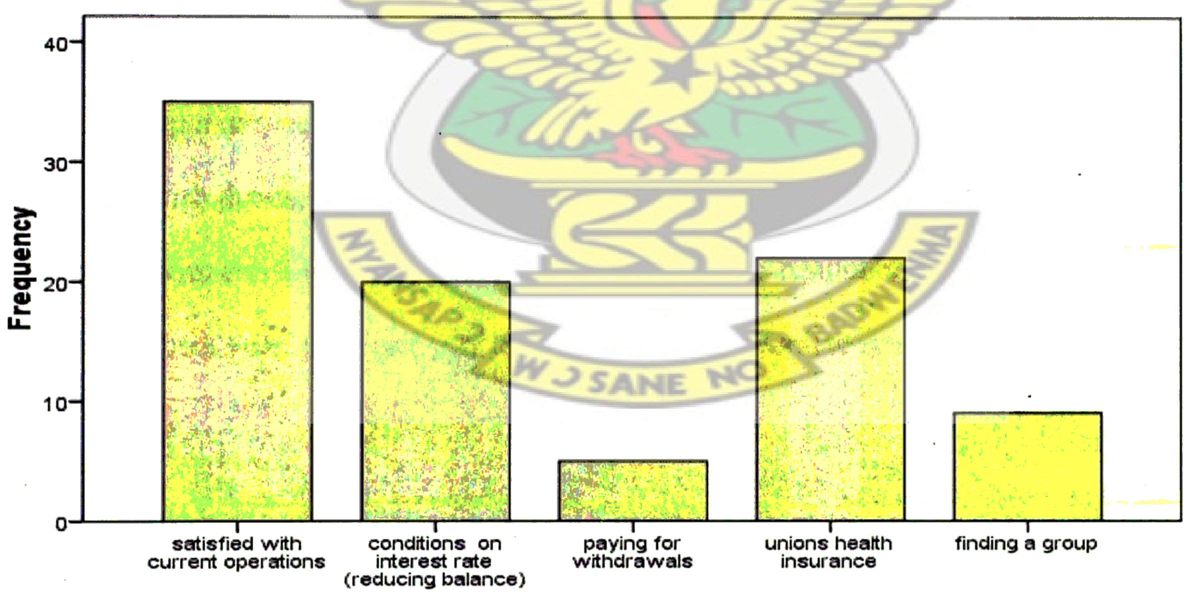


Figure 4.1.4 challenges client have with the credit risk management policy of the Credit Union

4.1.5 The number of times clients have assessed credit from the organization

Clients of the Union have assesses a number of credits this is illustrated in table 4.1.5

Table 4.1.5 number of times clients have assessed credit

No. of times clients have assessed credit	Frequency	Percent	Cumulative Percent
1-5	56	61.5	61.5
6-10	21	23.1	84.6
11-15	8	8.8	93.4
16-20	4	4.4	97.8
21-24	2	2.2	100.0
Total	91	100.0	

From the table above, 56 clients have assessed credit between one to five times. This group forms about 62%. While those who have assessed credit from six times to ten times forms 23% of the interviewed clients. From eleven times to fifteen times forms 8.8% and clients who have assessed credit from twenty one to twenty four times forms only 2.2%. The information given indicates that start ups clients assess quite a number of credit and as they are able to establish themselves or when their businesses expand to a point where they meet the criteria of commercial banks they leave the Micro Finance Institutions. This is because the commercial banks can give relatively larger credits than the micro finance institutions.

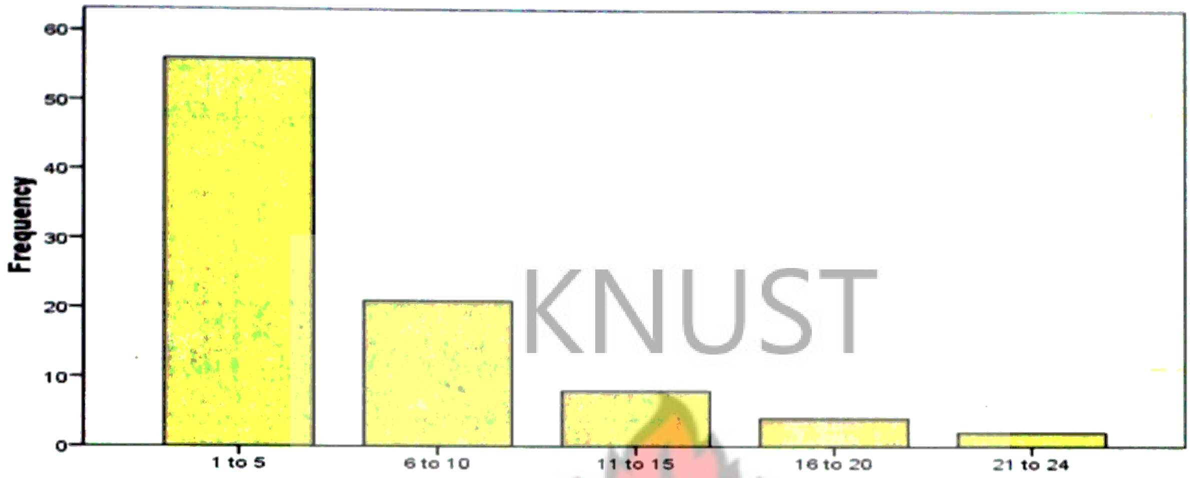


Figure 4.1.5. Number of times clients have assessed credit

From the chart one can see that clients who assessed credit many times are few. This supports that fact that Micro finance institutions are there to prepare the poor to be attractive to the normal banks. As clients who are now attractive to the commercial banks leave, new SMEs also join the union.

4.1.6 THINGS CLIENTS WISH THE CREDIT UNION CAN DO TO SERVE THEM BETTER

The respondents wish the following things could be done by the organization to enable them derive full benefit. This is shown in the frequency table below:

Table 4.1.6 Things clients wish the organization to do to serve them better

Wishes of clients	Frequency	Percent	Cumulative Percent
Increase loan multiple to 3 or 4	20	22.0	22.0
Use of property as collateral	13	14.3	36.3
Fastened loan processes	15	16.5	52.7
Personnel to visit client for daily money collection	8	8.8	61.5
Interest rate conditions should be reviewed	14	15.4	76.9
Internal health insurance should be reviewed	19	20.9	97.8
Organization of literacy programs	2	2.2	100.0
Total	91	100.0	

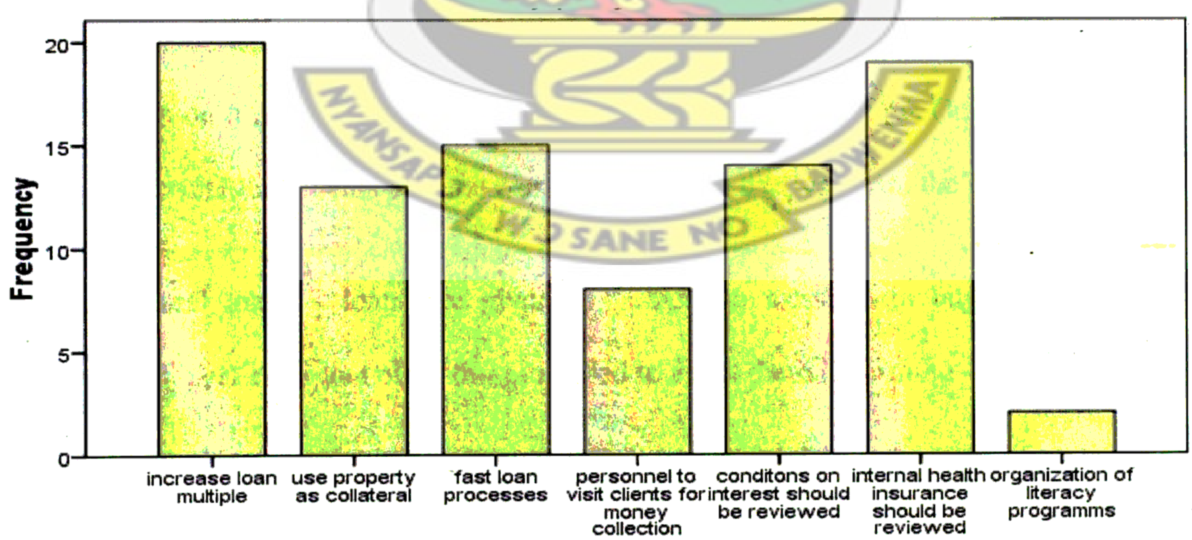
From the table above, 22% of the respondents wish that the loan multiple could be increased to three or four so that a lump sum could be advanced to help increase the benefit of the loans to clients. For example if a loan is for a car, some repairs may have to be done to enable the car function effectively or to enable clients by a car in good condition. If the loan is to serve as capital for a business, some lump sum can enable one enjoy high discounts as a result of bulk purchase of some specific items.

Also about 14% of clients wish they could use their assets as collateral for future loans and about 17% also wish that the processing of loans could be quickened to reduce the number of times they have to go to the credit union before they are able to secure their loans. 8.8 % also wishes that the organizations personnel could visit them daily to make daily deposit to reduce the possibilities of clients not being able to repay their loans within the stipulated time, resulting in an increase in the interest on the loan.

21% wish that the organizations health insurance could be optional and 15.4% wish that the increasing balance interest rates could be reviewed since all defaults are not intentional. They wish every default loan could be assessed on individual basis, so that clients do not suffer for circumstances beyond their control.

Also 2.2 % of clients wish that the Union could offer literacy classes to help clients in the illiteracy category understand their operations better and to manage their business well.

The above information is represented in figure 4.6.



4.2 THE IMPACT OF CREDIT RISK MANAGEMENT ON MICRO FINANCE INSTITUTIONS PROFITABILITY.

St. Peters Credit Union offers a range of financial products. These include the following:

- Savings - the Union gives its clients the opportunity to open a savings account. This enables them to save their reserves which they can depend on in times of need.
- Business Capital – business capital is offered to clients who have already established businesses and need extra capital for expansion or growth. The Union also gives business capital to its clients to start new ventures
- Provident Loans - they are loans given to clients in times of emergencies such as settling children school fees, hospital bills and funeral expenses.
- Investments – St. Peters Credit Union offers their clients the opportunity to invest in their organization by issuing shares to their clients. Before one becomes a member of the Union it is obligatory to at least buy GH¢40.00 shares of the Union. This is a way to ensure that clients become committed in their dealings with the Union.
- Agricultural loans – loans are given to farmers to assist them buy equipment, seedlings, pesticides and other things needed to assist them in farming.

4.2.1 The credit risk management policy of St. Peter's Credit Union

- Loan protection plan, clients need to take an insurance for the loan;

According to the credit officer, all loans have to be insured. The premium paid for insurance depends on the following:

1. The age of the credit beneficiary – the older the client, say fifty and above, the higher the premium and the younger the client the lower the premium.

2. The amount given as a loan – high premium to large amount and vice versa.

3. The duration to repay the loan- the longer the duration the more risk the Union is exposed to, so the higher the premium.

- **Group Loans**; For Loans above the client savings, the clients should belong to a group of a maximum of five or a minimum of three. The group members then serve as a guarantee to repay the loan in case there is a default. This enables the Union to transfer the default risk to the group members.

- **The use of photographs on client's application forms for easy identification;** With the use of photographs on loan application forms, clients are easily identified and this helps solve the problem of clients denying who they are.

- **Assessing savings and repayment patterns of clients;** Before loans are advanced clients are visited in their homes and enquiries are made from landlords on how regular the clients are, in paying their rent, light and water bills. This gives an idea of the commitment level of each client to their responsibilities. Assessing client savings records also gives an idea of whether the client is a potential defaulter.

- **The use of a tracking system that alerts credit officers on loans that are overdue;** With the use of a computer program, credit officers are alerted on loans that are overdue for one to three month. This helps the credit officers to take the necessary steps to recover the loans before they become bad debts.

4.2.2 Conditions clients are expected to meet for credit advancement

Before one can have access to a loan, the following conditions must be satisfied.

- One must have saved with the credit union for at least six months
- One must have registered and paid for the credit Unions health insurance
- One must belong to a group of not less than three members
- One must hold the minimum share of GH¢40.00.
- One must be a paid up member of the Credit Union's Welfare association

Although clients are able to meet all the conditions above they still encounter some difficulties in repaying the loans.

4.2.3 Reasons why clients are unable to repay credit

- Some clients are dishonest
- Some have genuine problem
- Problems with managing their business

4.2.4 Default rate of loans

St. Peter's Credit union started implementing credit risk management, in 2004. The default rate was very high before the implementation of credit risk management practices, but according to the Credit officer, the current default rate is manageable. This has been made possible with the introduction of the group system. Clients who are not members of any social or professionally recognized groups are not advanced loans above their savings. Those belonging to groups are advanced loans above their savings, (up to a maximum of thrice ones savings) and the group members pay the loan of a member who has defaulted.

CHAPTER FIVE

5. SUMMARY, RECOMMENDATIONS, LIMITATIONS OF STUDY AND CONCLUSION

This chapter summarizes the findings of the research. It also includes some recommendations for implementing credit risk management in micro finance institutions

5.1 SUMMARY OF FINDINGS

The findings of the study are summarized as follows:

It has been found that the credit risk management practices of Micro finance Institutions does not have a negative impact on its clients. This can be explained by the fact that client through credit advances have been able to have savings, acquire properties and have improved their living standards as explained in figure 4.1.3.

It was also noticed that credit risk management practices have reduced the high credit risk that Micro Finance Institutions face, to a manageable level which has resulted in increased profit levels. This means that as loans are being repaid loans can be made available to others and the recycle will go on and eventually help alleviate poverty in Ghana.

The research also showed that some clients who after saving with the Credit Union for a number of years, and could now meet the requirement for loans from normal banks, were still saving with the credit union. This was due to the relationship they had built with the union and the low interest rate they can take advantage of.

The introduction of the group systems helped the organization to transfer some of their credit risk to the group member, as each group member becomes each others watch dog to ensure that a member repays his or her loan.

The establishment of Micro Finance Institutions have really helped to improve the living standards of it's beneficiaries. This can be seen in terms of clients having savings which they can fall on in times of need. Clients have also been able to acquire properties and expand the various businesses.

Another finding was that the aim of establishing Micro Finance Institutions in Ghana is not far fetched. This was envisaged by the fact that 72% if St. Peter's Client falls within the SMEs sector as explained in figure 4.1.2.

5.2 RECOMMENDATIONS

Based on the findings of this research, risk management and profitability of Micro financial institutions are perfectly related. The following recommendations can be made on the part of Micro finance Institutions:

- Micro finance Institutions should practice a sound risk management policy in their organization. This will facilitate the handling of risk and enhance huge profits to be made thus fostering growth in the industry.
- The risk management of Micro financial institutions must set adequate liquidity level which will be used as a standard over the years for the sake of profitability, expanding financial worthiness and their clients' credibility.

- With regards to credit risks, Micro financial institutions must investigate the credit demand from borrowers and assess whether they are financially able to repay the loan in due terms in an optic of reducing credit risk.
- Information should be communicated to clients when and where necessary. That is changes in policies should be well communicated to clients.
- A monitoring and control system should be put in place to visit already advanced clients so as to identify the clients' problems and offer advices to reduce the chances of default.
- Intensifying the training programs for beneficiaries and also ensuring that they practice the knowledge acquired.

On the part of the clients' of St. Peter's Credit Union, the following recommendations have been made:

- Clients must be honest in their proposal for credit so that they might be offered the necessary advice on the purpose of the loans and what other service that may be appropriate for their proposal.
- Clients' must always keep the credit officer abreast with their business condition in order to be given the necessary advice to prevent the worse from happening.

5.3 CONCLUSION

During the course of this research, a theoretical framework was established to illustrate the theoretical relationship that exists between variables involved in the study. This involved a brief review of related literature, the relationship between these variables was tested empirically, to verify the influence of risk management on clients and default risk reduction. After conducting the necessary data and carrying out the necessary analysis, it was discovered that risk management has a positive impact on clients and helps reduce the high default rate faced by Micro financial institutions in Ghana.

Microfinance, the provision of financial services to the poor, has emerged as one of the promising pathways out of poverty

Microfinance has helped the poor to raise income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change.

Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc.

Moreover, for women, who, in many contexts, are secluded from public space, transacting with formal institutions can also build confidence and empowerment.

With the practice of sound credit risk management policies there is the hope that Micro Finance Institutions will be sustained for the benefit of all.

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APPENDIX

QUESTIONS FOR INTERVIEWING THE CREDIT OFFICER OF ST. PETER'S CREDIT UNION

All information supplies is purely for academic purpose and will be treated confidential

(1) What type of financial assistance do you offer to your clients?

i..

iii..

iii..

iv..

v..

(2)What are some of the conditions given before financial assistance is given?.

i..

ii..

iii………………………………………………………………………………

iv………………………………………………………………………………..

v…………………………………………………………………………

(3) Are clients able to meet these conditions?

Yes ☐ No ☐

(4) Are your clients able to repay without any difficulty?

Yes ☐ No ☐

(5) Give reasons:

………………………………………………………………………………………

………………………………………………………………………………………

………………………………………………………………………………………

(6) What is the loan repayment / Default rate?

………………………………………………………………………………………

………………………………………………………………………………………

………………………………………………………………………………………

……………………………………………………………………………………..

Questionnaire to assess the impact of credit risk management practices on clients of St. Peters Credit Union

(1) What is your name? ....

(2) What is your occupation…………………………………………..

(3) Where do you reside ………………………………………………………

(4) When did you start assessing Micro Credit from St. Peters Credit Union?

(5) What are some of the Micro Credit benefits that you have enjoyed from St. Peters Credit Union?

i…………………………………………………………………………………………..

ii…………………………………………………………………………………………

iii…………………………………………………………………………………………

(6)What are some of the problems encountered in dealing with St. Peters Credit Union

i…………………………………………………………………………………………..

ii…………………………………………………………………………………………

iii…………………………………………………………………………………………

(7) What are some of the conditions you have to meet before loans are granted?

i. ....

ii. ....

iii. ....

(8) Are you able to meet these conditions?

Yes ☐ No ☐

(9) How many times have you accessed credit from St. Peters Credit Union

....

10) What are some of the things you wish St. Peters Credit Union can undertake to serve you better?

i. ....

ii. ....

iii. ....

iv. ....