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Effect of Credit Management Systems on Loan Recovery Efforts of Microfinance Banks in Akwa Ibom State

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ABSTRACT: *This study set out to ascertain the effect of credit management techniques on loan recovery efforts by microfinance banks. To guide the study, 3 objectives specific objectives, 3 research questions and three null hypotheses tested at 0.05 alpha levels were formulated. The study covers all microfinance companies operating in Akwa Ibom State. A descriptive survey research design was employed for the study. The population was 85 operations and marketers in microfinance banks in Akwa Ibom State that have been in existence from 2014 to 2017. The sample size was 60 and the stratified random sampling technique was employed. The research instrument used for the study was a researcher- made questionnaire tagged "Credit Management and Loan Recovery Questionnaire" (CMLRQ). The instrument developed by the researcher was face and content validated by three experts in the Faculty of Social sciences, Akwa Ibom State University. All corrections and inputs were built in to the final version of the instrument. The reliability coefficient of the instrument was determined using Cronbach alpha method after the instrument was trial-tested on 20 respondents who were part of the population but not part of the sample. The result showed reliability co-efficient of 0.78. The data generated was analyzed using regression analysis to answer the* *research questions and to test the null hypotheses at .05 alpha level. It was concluded that Credit appraisal, credit risk control and collection policy were found to be very important in influencing loan recovery. It was recommended among others that Microfinance banks should ensure that credit appraisal is carried out by the technical people who are experienced and competent credit officer in order to stem out those with intolerable credit risk at the earliest possible opportunity.*

KEYWORDS: credit management systems, loan recovery, microfinance banks, Akwa Ibom State

INTRODUCTION

The banking industry play a vital role in economic development of any nation, they play roles like fund mobilizations, opening of account, letters of credit business guarantees, and mostly give out loans from the part of the money mobilized. Banks are financial institutions are established for lending, borrowing, issuing, exchanging, taking deposits, safeguarding or handling money under the laws and guide lines of a respective country. Among their activities, credit provision is the main product which banks provide to potential business entrepreneurs as a main source of generating income.

Credit management is one of the most important activities in any company and cannot be overlooked by any economic enterprise engaged in credit irrespective of its business nature. It is the process to ensure that customers will pay for the products delivered or the services rendered. Myers and Brealey (2003) describe credit management as methods and strategies adopted by a firm to ensure that they maintain an optimal level of credit and its effective management. It is an aspect of financial management involving credit analysis, credit rating, credit classification and credit reporting. Nelson (2002) views credit management as simply the means by which an entity manages its credit sales. It is a prerequisite for any entity dealing with credit transactions since it is impossible to have a zero credit or default risk. Banks are merely custodians of the money they lend; hence interest must be paid to depositors and dividends to the investors. Credit management can be seen as an integral part of lending and as such in its absence, good loans can turn bad. It is expedient to note that the importance of credit management cannot be over-emphasized and good credit management requires the establishment of adherence to and of sound and efficient credit policies of government.

For banks to be successful, their corporate credit appraisal, disbursement, adequate monitoring and repayment must be assured. But experiences over the years have shown that inadequate credit analysis and sound judgment of loans application have resulted in unperforming loans. Provision of credits according to Agu and Basil (2013), which are in the form of loans and advances, are the total amount of money a given bank lends out to its customers at any given period of time. In providing credits for business ventures, banks should as a matter of importance take all necessary steps to ensure that advances are granted to those customers who can and will make judicious use of loans so that repayment will not become a problem. Therefore, credits must be made to people who are capable of utilizing it well and repaying the loan at its maturity. The place of loans and advances in the affairs of banks can be explained by referring to the fact that "loans and advances are the largest single item in the assets structures of Nigeria commercial Banks (Ani 2012). It also constitutes the main source of the operating income of banks and also the most profitable assets for the employment of banks funds. Credit management systems include credit appraisal, credit risk control ad collection policy (Knox, 2004).

A key requirement for effective credit management according to Alice and Jaya (2016) is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. Credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It follows that principles of goods lending shall be concerned with ensuring, so far as possible that the borrower will be able to make scheduled payments with interest in full and within the required time period otherwise, the profit from an interest earned is reduced or even wiped out by the bad debt when the customer eventually defaults. Credit management is concerned primarily with managing debtors and financing debts. The objectives of credit management can be stated as safe guarding the companies" investments in debtors and optimizing operational cash flows. Policies and procedures must be applied for granting credit to customers, collecting payment and limiting the risk of non-payments.

Statement of the Problem

Credit risk management practices is an issue of concern in financial institutions today and there is need to develop improved processes and systems to deliver better visibility into future performance. There have been controversies among researchers on the effect of credit management techniques adopted by various institutions. The success of microfinance banks is largely dependent on the effectiveness of their credit management system. Since these institutions generate most of their income from interest earned on loans extended to small and medium entrepreneurs. The central bank annual supervision report, 2015 indicated high incidence of credit risk reflected in the rising levels of non-performing loans by the commercial banks in the last 10 years, a situation that has adversely impacted on their profitability. This trend not only threatens the viability and sustainability of microfinance banks, but also hinders the achievement of the goals for which they were intended which are to provide credit to the middle and lower income class but also to the rural unbanked population and bridge the financing gap in the mainstream financial sector. Bad credit can be stemmed out by proper risk identification and appraisal. Sound credit management is a prerequisite for a financial institution's stability and continuing profitability, while deteriorating credit quality is the most frequent cause of poor financial performance and condition. According to Gitman (1997), the probability of bad debts increases as credit standards are relaxed. Firms must therefore ensure that the management of receivables is efficient and effective. Such delays on collecting cash from debtors as they fall due has serious financial problems, increased bad debts and affects customer relations. If payment is made late, then profitability is eroded and if payment is not made at all, then a total loss is incurred. This study therefore aimed at establishing the influence of credit management systems on loan performance of microfinance banks in Akwa Ibom State, Nigeria.

Objectives of the Study

The general objective for this study was to establish the effect of credit management systems on the loan recovery efforts of microfinance banks in Akwa Ibom State. Specifically, the study sought to

1. To determine the effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State.
2. To determine the effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State.
3. To determine the effect of collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State.

Research Hypotheses

The following null hypotheses were tested at .05 level of significance

1. There is no significant effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State.
2. There is no significant effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State.

3. There is no significant effect of collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State.

REVIEW OF RELATED LITERATURE

Conceptual Framework

The Concept of Microfinance

Microfinance according to Nduta (2013) is the supply of loans, savings, and other basic financial services to the poor." As these financial services usually involve small amounts of money - small loans, small savings, the term "microfinance" helps to differentiate these services from those which formal banks provide. Microfinance institutions provide a reliable source of financial support and assistance compared to other sources for financing. Sources operating outside the microfinance industry typically form informal relationships with borrowers and have no real legal or substantial ties with their customers. As a result, loan terms tend to carry high costs with no guarantee that lenders will remain in one place for any length. In contrast, microfinance institutions typically work alongside government organizations and also have ties with larger global organizations.

As with any financial institution, the biggest risk in microfinance is lending money and not getting it back. Credit risk is a particular concern for MFIs because most micro lending is unsecured (i.e., traditional collateral is not often used to secure microloans (Knox, 2004). The people covered are those who cannot avail credit from banks and such other financial institutions due to the lack of the ability to provide guarantee or security against the money borrowed. Many banks do not extend credit to these kinds of people due to the high default risk for repayment of interest and in some cases the principle amount itself. Therefore, these institutions required to design sound credit management that entails the identification of existing and potential risks inherent in lending activities. Timely identification of potential credit default is important as high default rates lead to decreased cash flows, lower liquidity levels and financial distress. In contrast, lower credit exposure means an optimal debtors' level with reduced chances of bad debts and therefore financial health. According to Scheufler (2002), in today`s business environment risk management and improvement of cash flows are very challenging.

The Concept of Credit Risk Management

Credit risk management is a structured approach to managing uncertainties through risk assessment, developing strategies to manage it, and mitigation of risk using managerial resources.

The strategies include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk. The process of risk management is a two-step process. The first is to identify the source of the risk, which is to identify the leading variables causing the risk. The second is to devise methods to quantify the risk using mathematical models, in order to understand the risk profile of the instrument. Once a general framework of risk identification and management is developed, the techniques can be applied to different situations, products, instruments and institutions. It is crucial for banks to have comprehensive risk management framework as there is a growing realization that sustainable growth critically depends on the development of a comprehensive risk management framework (Greuning and Iqbal, 2007).

Risk management is a complex task for any organization and increasingly important in a world where economic events are linked. It is a two-step process. The first is to identify the source of the risk, which is to identify the leading variables causing the risk. The second is to devise methods to quantify the risk using mathematical models, in order to understand the risk profile of the instrument (Kealhofer, 2003). The techniques of risk identification are facilitative tools intended to maximize the opportunity of identifying all the risks or hazards inherent in a particular facility, system, or product. The tools may be categorized under the broad headings of intuitive, inductive and deductive techniques. Once a general framework of risk identification and management is developed, techniques can be applied to different situations, products, instruments and institutions. Peters, (1989) described the development of a conceptual model of how auditors assess inherent risk in a normal audit environment and its implementation as a knowledge-based (expert) system. They asserted that the auditor begins the inherent risk evaluation process by generating expectations of accounts balances. The addition of risk evaluation completes the process of risk assessment. British Standard 4778 considers risk assessment to refer to analysis of inherent risks and their significance in an appropriate context. Organizations are exposed to various types of risks which can come from uncertainty in financial variables (financial risk), project failures, legal liabilities, accidents, natural causes and disasters as well as deliberate attacks from an adversary, (Saunders, 1996).

Credit Appraisal and Loan Recovery Efforts of Microfinance Banks

The process of credit management begins with accurately assessing the credit-worthiness of the customer base and his/her business viability. This is particularly important if the company chooses to extend some type of credit line or revolving credit to certain customers. Hence, proper credit management is setting specific criteria that a customer must meet before receiving the proposed credit arrangement. As part of the evaluation process, credit management also calls for determining the total credit line that will be extended to a given customer. Credit appraisal of a term loan denotes evaluating the proposal of the loan to find out repayment capacity of the borrower. The primary objective is to ensure the safety of the money of the bank and its customers. The process involves an appraisal of market, management, technical, and financial. The company asking for the term loan has to go through several tests. The bank follows an extensive process of credit appraisal before sanctioning any loan. It analyses the loan proposal from all angles. The primary objective of credit appraisal is to ensure that the money is given in right hands and the capital and interest income of the bank is relatively secured (Lawrence, 2009).

While appraising term loans, a financial institution would focus on evaluating the credit-worthiness of the company and future expected stream of cash flow with the amount of risk attached to them. Credit worthiness is assessed with parameters such as the willingness of promoters to pay the money back and repayment capacity of the borrower (Njeru, Shano, & Alex, 2013).
Four broad areas of appraisal by banks are a market, management, technical and management.

Theoretical Framework

Information Asymmetry Theory

Information asymmetry theory describes the condition in which relevant information is not known to all parties involved in an undertaking (Ekumah & Essel, 2003). Eppy (2005) describes a condition in which all parties involved in an undertaking do not know relevant information. The theory point out that perceived information asymmetry poses two problems for the financial institution, moral hazard, monitoring entrepreneurial behavior and adverse selection that is making errors in lending decisions. The theory informs the study in that if credit unions exchange information about their clients' credit worth, they can assess also the quality of foreign credit applicants and lend to them as carefully as they lend to local customers (Denis, 2010). By reducing information asymmetry between lenders and borrowers, credit registries allow loans to be extended to safe borrowers who had previously been priced out of the market, resulting in higher aggregate lending and low default rates. Transaction cost theory has proven to be an essential framework for decisions on the vertical boundaries of a firm. Williamson (2000), indicated that transaction occurs when a good or service is transferred across a technologically separable interfaces. One stage of activity terminates and another one begins. First developed by Schwartz (1974), this theory conjectures that suppliers may have an advantage over traditional lenders in checking the real financial situation or the credit worthiness of their clients. Suppliers also have a better ability to monitor and force repayment of the credit. All these superiorities may give suppliers a cost advantage when compared with financial institutions. Derban, Binner and Mullineux (2005) recommended that borrowers should be screened especially by banking institutions in form of credit assessment. Collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening as indicated by symmetric information theory.

Transactions Costs Theory

First developed by Schwartz (1974), this theory conjectures that suppliers may have an advantage over traditional lenders in checking the real financial situation or the credit worthiness of their clients. Suppliers also have a better ability to monitor and force repayment of the credit. All these superiorities may give suppliers a cost advantage when compared with financial institutions. Three sources of cost advantage were classified by Petersen and Rajan (1997) as follows: information acquisition, controlling the buyer and salvaging value from existing assets. The first source of cost advantage can be explained by the fact that sellers can get information about buyers faster and at lower cost because it is obtained in the normal course of business. That is, the frequency and the amount of the buyer's orders give suppliers an idea of the client's situation; the buyer`s rejection of discounts for early payment may serve to alert the supplier of a weakening in the credit-worthiness of the buyer, and sellers usually visit customers more often than financial institutions do.

Empirical Review

In Africa among other developing economies, microfinance institutions are the main source of funding for microenterprises and thus credit policies play an important role in risks management of most financial institutions. Omara (2007) in Uganda to investigate on the credit assessment process and repayment of bank loans; a case study of Barclays was done. A sample of 73 respondents were interviewed and the results of the study showed that there was delay by Barclays bank in scoring loans, the bank charged commitment fee to both new and existing customers. This negatively impacted on loan repayment.

In Ghana, Ntiamoah, Egyiri, Diana Fiaklou, Kwamega, (2014) asserted that there existed a significant relationship between credit management practices and loan performance using some selected microfinance in the Greater Accra region of Ghana as a case study. Results of the study indicated that there was high positive correlation between the credit terms and policy, lending, credit analysis and appraisal, and credit risk control and loan performance.

METHODOLOGY

A survey research design approach was adopted for the study. The population consisted of 85 operations and marketers in microfinance banks in Akwa Ibom State that have been in existence from 2017 to 2022. Stratified random sampling technique was further employed to arrive at a sample size of 60 respondents for the study. Primary and secondary data were used and the primary data were generated through firsthand information gathered from operations and marketers in microfinance banks in Akwa Ibom State. Secondary data was collected from clients' files, reports, directives, manuals and bulletins of the banks by the researcher.

Data collected from primary sources were further analyzed with the Pearson's Product Moment Correlation (PPMC) to ascertain the relationship that exist between the independent and dependent variables. The test was carried out at a 95% Confidence interval, with 5% (0.05) level of significance. The reliability was determined through the Cronbach alpha reliability test. The resulting coefficient for 16 items was 0.86. Since the result co-efficient was above the threshold of 0.5, the instrument was ascertained reliable and adopted for the study.

PRESENTATION OF RESULTS AND DISCUSSION OF FINDINGS

Null Hypothesis 1

There is no significant effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State.

Table 1: Summary of Regression analysis for effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State

Model		Sum of Squares	df	Mean Square	Fcal	Fcrit.	Decision
1	Regression	49.639	4	12.410	385.082	2.543	Reject Ho
	Residual	4.705	54	.032			
	Total	54.344	60				

Significant @ .05

Table1: gives the summary of the regression test. The result shows that the calculated F- value is 385.082. At 4 and 54 degree of freedom and .05 alpha level, the critical F value is 2.543. Since the fcal is greater than the fcrit, the null hypothesis is rejected and the alternate is upheld. Thus, there is a significant effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State.

Null Hypothesis 2

There is no significant effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State.

Table 2: Summary of Regression analysis for effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State

Model		Sum of Squares	df	Mean Square	Fcal	Fcrit.	Decision
1	Regression	39.680	1	39.680	403.189	.2.528	Reject Ho
	Residual	14.664	59	.098			
	Total	54.344	60				

Significant @ .05

Table 5 gives the summary of the regression test. The result shows that the calculated F- value is 403.189. At 1 and 59 degree of freedom and .05 alpha level, the critical F value is 2.528. Since the fcal is greater than the fcrit, the null hypothesis is rejected and the alternate is upheld. Thus, there is a significant effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State.

Null Hypothesis 3

There is no significant effect of collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State.

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Table 3: Summary of Regression analysis for effect of credit collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State

Model		Sum of Squares	df	Mean Square	Fcal	Fcrit.	Decision
1	Regression	46.036	1	46.036	825.588	.2.528	Reject Ho
	Residual	8.308	149	.056			
	Total	54.344	150				

Significant @ .05

Table 6 gives the summary of the regression test. The result shows that the calculated F- value is 825.588. At 1 and 59 degree of freedom and .05 alpha level, the critical F value is 2.528. Since the fcal is greater than the fcrit, the null hypothesis is rejected and the alternate is upheld. Thus, there is a significant effect of credit collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State.

DISCUSSION OF FINDINGS

Based on the result of analysis, the findings are hereby discussed

Credit Appraisal and Loan Recovery Efforts of Microfinance Banks

Analysis of research question one shows that the coefficient of determination (R^2) is 0.56, indicating that 56% of loan recovered is as a result of credit appraisal techniques. The r-value is 0.65, indicating a positive relationship between credit appraisal and loan recovery. Thus, credit appraisal has a positive effect on loan recovery by microfinance banks. The corresponding hypothesis test reveals that there is a significant effect of credit appraisal on loan recovery efforts of microfinance banks in Akwa Ibom State. This finding is in line with Lawrence 2009 and Njeru, Shano, & Alex (2013) which identified four key processes in credit appraisal to include market appraisal, management appraisal, technical appraisal and financial appraisal techniques. Omara (2007) in Uganda investigated the credit assessment process and repayment of bank loans. The results of the study showed that there was delay by Barclays bank in scoring loans, the bank charged commitment fee to both new and existing customers. This negatively impacted on loan repayment.

Credit Risk Control and Loan Recovery Efforts of Microfinance Banks

Result of research question two shows analysis that the coefficient of determination (R^2) is 0.73, indicating that 73% of loan recovered is as a result of credit appraisal techniques. The r-value is 0.84, indicating a very high positive relationship between credit risk control and loan recovery. Thus, credit risk control has a positive effect on loan recovery by microfinance banks. The corresponding hypothesis test reveals that there is a significant effect of credit risk control on loan recovery efforts of microfinance banks in Akwa Ibom State. This finding is corroborated by Ntiamoah, Egyiri, Diana Fiaklou, Kwamega, (2014) which averred that there existed a significant relationship between credit management practices and loan performance using some selected microfinance in the Greater Accra region of Ghana as a case study. Results of the study indicated that there was high positive correlation between the credit terms and policy, lending, credit analysis and appraisal, and credit risk control and loan performance. Credit risk controls adopted by microfinance institutions have an effect on loan performance, credit insurance, signing of covenants with customers, diversification of loans, credit rating of customers, reports on financial conditions, refrain from further borrowing had an effect on loan performance. Collection policies adopted by microfinance institution had an effect on loan performance, stringent policy had a great impact on loan performance, and the lenient policy had an effect but was not as great as that of stringent policy (Nduta, 2013).

Credit Collection Policy and Loan Recovery Efforts of Microfinance Banks

Result of research question three shows analysis that the coefficient of determination (R^2) is 0.847, indicating that 84.7% of loan recovered is as a result of credit collection policy techniques. The r-value is 0.92, indicating a very high positive relationship between credit collection policy and loan recovery. Thus, credit collection policy has a positive effect on loan recovery by microfinance banks. The corresponding hypothesis test reveals that there is a significant effect of credit collection policy on loan recovery efforts of microfinance banks in Akwa Ibom State. This finding is supported by Vincent Byusa & David Nkusi (2012) which investigated effects of credit policy on bank performance in selected Rwandan commercial banks and revealed that credit policies, credit responsibility, collection policy and credit evaluation policies ranging from car loans, personal loans, overdraft and mortgage at interest led to increase in customer base and existence of bad debts.

CONCLUSION

Credit appraisal was found to be very important in influencing loan recovery. This is because it is the screening stage and those would be bad payers are sieved out and those expected to be good payers given their credit history and credit score are granted. The other techniques were also deemed effective with collections techniques having the most effect on loan retrieval.

Recommendations

The following recommendations were made based on the findings and conclusion from the study.

1. Microfinance banks should ensure that credit appraisal is carried out by the technical people who are experienced and competent credit officer in order to stem out those with intolerable credit risk at the earliest possible opportunity.
2. Microfinance banks should ensure a multi-variate approach to credit risk appraisal. This would ensure that there is very little chance that would be defaulter is identified and locked out of the loan book.
3. Microfinance banks should ensure that credit risk control is conducted by competent people for screening loan applications to ensure high recovery rate.
4. In the event of default or NPA, the collection procedure outline in the research should be applied by Microfinance banks for loan recovery.

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