

**Assessment of Performance of Micro Finance  
Institutions in Credit Risk Management: the case  
of five Micro Finance Institutions in Addis Ababa**

*A Thesis Submitted to the School of Graduate Studies, Addis  
Ababa University in Partial Fulfilment of the Requirements for the  
Degree of Master of Science in Accounting and Finance*

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**June, 2011**

**Addis Ababa**

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**Addis Ababa University  
School of Graduate Studies**

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## Declaration

I declare that the work presented here in is genuine work done originally by me and has not been published or submitted else where for the requirement of a degree programme.

Any literature, data or works done by other and cited with in this thesis had been due acknowledgement and listed in reference section.

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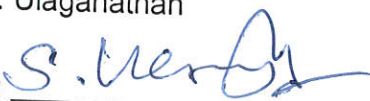
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Date of Approval: 21-06-2011

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## **Abbreviations and Acronyms**

ADCSI	Addis Credit and Saving Institutions
AEMFI	Association of Ethiopian Micro Finance Institutions
AVFSI	Africa Village Financial Service Institutions
BGMF	Bussa Gonofa Micro Finance
CRMC	Credit Risk Management Committee
CRMD	Credit Risk Management Department
GMF	Gasha Micro Finance
MFI	Micro Finance Institutions
MIS	Management Information System
NGO	Non Governmental Organizations
PAR	Portfolio At Risk
RR	Repayment Rate
SFPI	Specialized Financial and Promotion Institutions

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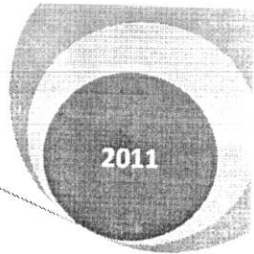
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### **Abstract**

Risk is the fundamental element that drives financial behaviour of micro finance institutions. Financial Institutions, therefore, should manage the risk efficiently to survive in this highly uncertain world. The future of micro finance institutions will undoubtedly rest on risk management dynamics. Only those micro finance institutions that have efficient risk management system will survive in the market in the long run. The effective management of credit risk is a critical component of comprehensive risk management essential for long-term success of a micro finance institution that is why a micro finance's success lies in its ability to manage a risk.

The study was tried to evaluate the performance sample micro finance institutions in credit risk management. To conduct this study the researcher were employed mixed approach and used questionnaires, interview and document analysis as a source of data. The data obtained from different sources were analyzed and presented the findings. In conclusion the study were tries to seek to outline the components of an effective credit risk management system and also were try to find the failure to effectively manage credit risk contributed to a greater extent to the micro finance institutions crisis.



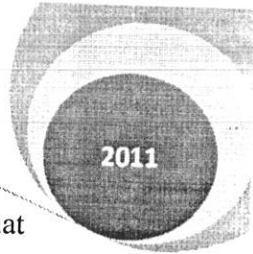
## Chapter One

### 1 Introduction

#### 1.1 Back ground of the study

Credit risk has become a necessary consequence of a vibrant and ever changing economy, because the economy is supported mostly by the interference of financial institutions (Jennifer et al. 2008). Due to such effect commitment to prudent lending has become a major concern and discussion issue in a global financial institutions context today. In this regard Ahmed (2002) noted that without the provision of credit from country's financial institution especially through micro financial institutions, no development of modern industrial community and fostering of investment that is achieving the target growth of economy by the state would have been impossible. As a result most of the financial institution and micro finance industries are looking into managing their credit risks in different business cycle and environment that can help to alleviate crisis and major losses that could damage long term functionality of the institutions. Therefore effective credit risk management is very essential to achieve this economic objectives and to optimizing the performance of financial institutions.

Credit risk is one of the main risks that seriously affect micro financial institutions' viability (GTZ 2000). Credit risk can be arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the financial institutions (Santomero 1997).



Therefore these institutions required to design sound credit risk management that entails the identification of existing and potential risks inherent in lending activities. Micro finance institutions in Ethiopia are not different from the other world micro finance institutions. Therefore they are also entitled to design sound credit risk management in order to achieve their desired objectives.

Credit risk management incorporates decision making process; before the credit decision is made, follow up of credit commitments including all monitoring and reporting process (Fayman and T. He 2011).

Chua et al. (2000) also noted that the credit decision is based on the financial data and judgmental assessment of the market outlook, borrower, management and shareholders. The follow-up is carried out through periodic reporting reviews of the micro finance institutions commitments by customer (Chua et al. 2000).

Credit risk management is one of the key functions of the micro financial institutions. Those micro financial institutions, which analyze credit risks more consciously, protect themselves from negative events, thus obtaining comparative advantage over competitors. That is why careful credit risk management is important for smooth cash flow and success of overall financial performance of micro finance institutions.

## **1.2 Statement of Problem**

Credit risk management challenges are implicit in financial institutions (including micro finance institutions) activities because credit risk events are typically uncertain (Laurentis 2009). Therefore as Nancy et al. (2001) noted an effective credit risk management process is required to help institution's top leadership establish rules to prevent operating losses due to human error, employee carelessness, technological malfunction or fraud. To illustrate, a micro finance's management may put into place internal controls and procedures as well as periodic internal audit reviews to ensure that employees comply with rules when performing duties in credit risk management. A credit risk management policy also may cover financial risks of financial institutions (Codija n.d).

Al-Tamimi and Al-Mazrooei (2007) cited in Shafiq and Nasr (undated) also noted that financial institutions including micro finance institutions is a business mostly associated with credit risk because of its large exposure to uncertainty. They also noted that credit risk management is one of MFI liabilities of the operations and procedures being followed. In today's dynamic environment, all micro finance institutions are exposed to potential credit risks. Due to such exposure to credit risks, efficient credit risk management is required. Chua et al. (2000) also found that managing credit risk is one of the basic tasks to be done in micro financial institutions, once it has been identified and known.



According to chua et al. (2000) the micro finance industry recognizes that an institution needs not do business in a manner that unnecessarily imposes risk upon it; nor should it absorb risk that can be efficiently transferred to other participants.

Rather, it should only manage risks at the firm level that are more efficiently managed there than by the market itself or by their owners in their own portfolios. In short, it should accept only those risks that are uniquely a part of the micro finance institutions array of services.

As a result effective and sound credit risk management is a foundation for the safe and sound operation of a micro finance institution to improve their performance. Therefore the purpose of this thesis is to assess the performance of micro finance institutions in Addis Ababa in credit risk management. In connection with this issue different empirical studies are conducted internationally. The following are some of them.

Nawai and Shariff (2010) in their study found that close and informal relationship between MFIs and borrowers help in monitoring and early detection of problems that may arise in non-repayment of loans that finally lead to credit risk.

Laurentis and Mattei (2009) in their study of Lessors' recovery risk management capability shows that the development of modern reliable systems of risk management like credit scoring can enhance even more those management capabilities.

Chua et al. (2000) conduct research on microfinance, risk management, and poverty found that the relationship between risks to the client and risks to the loan portfolio has been largely important to the microfinance industry.

Bhatia (2004) in his study of mitigating currency risk for investing in microfinance institutions in developing countries found that there is a clear tradeoff for investors mitigating currency risk in list developed countries in the form of contract fees for the benefit of protection against currency fluctuations.

Wenner et al. (2007) conduct research on managing credit risk in financial Institutions in Latin America. In their study they found that donors and governments can assist in the capture and dissemination of relevant information that would serve to reduce asymmetries that contribute to credit risk.

A. Fernand (undated) conduct research study on managing microfinance risks: some observations and suggestions stated that risk management has become more important now and its importance will continue to grow in the future. Factors such as the increasing competition in markets and the integration of new technology into the industry further reinforce the importance of microfinance risk management. The growing interest of MFIs further reinforces the importance of risk management in MFIs. However, it is disturbing to note that systematic risk management is still not as widespread as it should be.

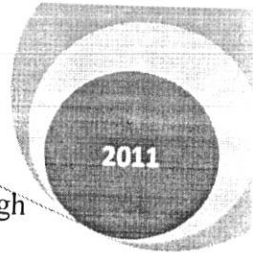
Thierry van Bastelaer (2000) in his study of imperfect information, social capital and the poor access to credit found that well-documented inter-borrower relations and quality of the relation between the borrowers and the lender organization's staff plays an important role in credit risk management.

Nagarajan (2001) in his study of risk management for microfinance institutions in Mozambique found that risk management is a dynamic process that could ideally be developed during normal times and tested at the wake of risk.

It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that it is possible to minimize risks related losses through diligent management of portfolio and cash-flow, by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders during the normal times and through choice of relevant products and strategies to mitigate and cope with risk.

In Ethiopia, the studies by Wolday (2001), Befkadu (2007), Zigju (2008), and Michael (2006) focus on progress of micro finance institutions in terms of number of clients, loan amount and number of branches the institutions have throughout the country. The studies by Michael (2006) and Samuel (2006) tries to touch the issue of credit risk management in some micro finance institutions in Ethiopia but they did not assess exhaustively the performance of micro finance institutions in credit risk management. For example the study by Samuel only focuses on one micro finance institution.

The empirical studies that have been reviewed in the preceding section focused on the different micro finance institutions issues that affect the performance of micro finance institutions. In addition, most prior studies regarding credit risk management tried to examine the possible methods to manage credit risk including the use of credit score rating, and the impact of borrower's financial positions on credit risk management and the impact of relation of borrower and lender on credit risk management.



However, to the knowledge of the researcher, it is possible to concluded that although there have been a number of studies on credit risk management and related issues both in developed and developing countries, Ethiopia in particular, it is difficult to believe that these studies exhaustively examine the credit risk management practice of micro finance institutions specially in our country Ethiopia.

As a result, this study were designed to fill the aforementioned gaps ( particularly in our country Ethiopia) and provide concluding recommends having the main objective of assessing and examining the performance of micro finance institutions in credit risk management.

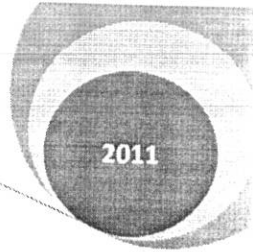
### **1.3 Research Questions**

This study attempts to answer the following questions:

- RQ1. Do the institutions' staffs understand risk and risk management?
- RQ2. Have the institutions clearly identified the potential risks relating to each of their declared aims and objectives?
- RQ3. Do the institutions efficiently assess and analyze risk in general?
- RQ4. Do the institutions have an efficient risk monitoring and controlling system?
- RQ5. Do the institutions have efficient risk management?

### **1.4 Objective of the Study**

The main objective of this concurrent mixed approach study is to empirically assess the performance of sample micro finance institutions in credit risk management case of Addis Ababa.

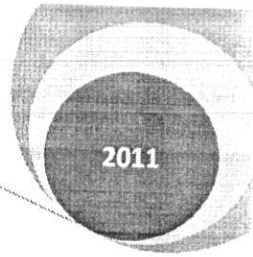


#### **1.4.1 Specific objectives**

- ◆ To evaluate the credit risk management practices of selected micro finance institutions in Addis Ababa.
- ◆ To assess and identify the possible sources of credit risk in micro finance institutions.
- ◆ To see the efficiency and effectiveness of institutions in internal credit quality review to manage credit risk.
- ◆ To assess the institution's practice in credit administration and loan documentation procedures to manage credit risk.
- ◆ To recommend alternative solutions for the actual problems that will be identified by this research

#### **1.5 Scope and Limitation of the Study**

The researcher believes that the findings of this study would have been more productive if it has been conducted on all micro finance institutions in Ethiopia. However, due to time and financial constraints, it is out of the reach of the researcher to incorporate all micro finance institutions in this study. Due to this, the paper is limited to five purposively selected micro finance institutions in Addis Ababa. Besides, the research was also subjected to limitation of empirical research because no more access of previous research on the issue of micro finance institutions performance in credit risk management especially in Ethiopia.



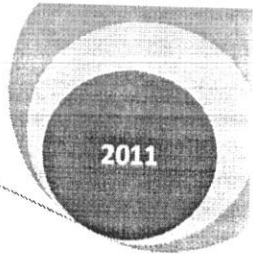
### **1.6 Significance of the study**

The researcher believes that the result of this research will contribute the following significances.

- ◆ This paper could be used as an initiation for those who are interested to conduct a detailed and comprehensive study regarding the performance of micro finance institutions in credit risk management practice.
- ◆ It will enable the governing body, specifically the managements, and the higher responsible body, risk management department of the institutions to be aware of about credit risk management and its effect on growth of institutions income.

### **1.7 Organization of the Paper**

This study was organized in to five chapters. The first chapter is background of the study and it includes introduction about the study, statement of the problem, general and specific objectives, scope of the study, significance of the study and limitation of the study. The second chapter is related literature review and it encompasses theoretical concept and empirical studies focused on the topic. The third chapter contains the research methodology detail used by the researcher. The fourth chapter is data presentation and analysis by using the method adopted to test objectives and answer questions and interpretation of the result from the analysis is also included under this chapter. The fifth chapter includes the study findings, conclusions and some recommendations forwarded by the researcher.



## Chapter Two

### Review of Related Literature

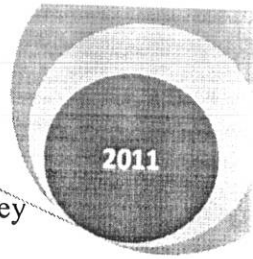
#### 2.1 Theoretical Review

According to risk management frame work in micro finance institutions by GTZ (released in 2000) risk is an integral part of financial services. When financial institutions issue loans, there is a risk of borrower default. When MFI collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. According to GTZ frame work any institution that conducts cash transactions or makes investments risks the loss of those funds. Development finance institutions should neither avoid risk nor ignore risk. Like others financial institutions, microfinance institutions (MFIs) face risks that they must manage efficiently and effectively to be successful. If the MFI does not manage its risks well, it will likely fail to meet its social and financial objectives. As Nancy et al.(2001) noted when poorly managed risks begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, MFI is not able to meet its social objective of providing services to the poor and quickly goes out of business. Nancy et al. (2001) also noted that managing risk is a complex task for any financial organization, and increasingly important in a world where economic events and financial systems are linked. Global financial institutions have emphasized risk

management as an essential element of long-term success. Rather than focusing on current or historical financial performance, management and regulators now focus on an organization's ability to identify and manage future risks as the best predictor of long-term success.

Therefore since micro finance institutions are part of these financial institutions they are also be aware of about risk particularly credit risk they face and the way how to manage these risks.

On the other hand microfinance institutions (MFIs) were established to fill the gap in the financial services sector by providing funds to the poor and lower income group and thus alleviating poverty and enhance their business activities. The MFIs also provide funds for start-up business or for working capital (Woller et al., n.d). In addition, some MFIs also provide funds for non-business activities such as for education and emergencies purpose. In doing so agency problems like, moral hazard and adverse selection of clients exist because of information asymmetries. Information asymmetries are the main obstacle for MFIs to provide loans to clients. This finally result credit risk which is the one that negatively affect the performance of MFIs (Nawai 2010). Therefore efficient credit risk management is required. According to Silwal (2003) to minimize these problems financial institutions usually requires business proposal, borrower past credit information and collateral before approving the loan. MFIs also offer credit through group-based lending method to mitigate agency problems, moral hazard and adverse selection and to replace the collateral requirement.



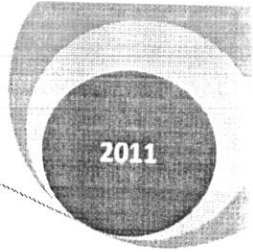
In group-based lending, borrowers must form a group before applying loans and they also responsible to other loan members. If one member default, the others will be responsible to pay the loan or they will be denied access for the next loans.

## **2.2 Categories of Credit Risk in Financial Institutions**

To gain a better understanding on the nature of credit risk, it is necessary to introduce the types of credit risk involved in financial activities before any further discussion. Concerning the categorizing of credit risk, different authors have expressed various criteria.

For example, As Hennie (2003) cited in xiuzhu (2007) points out in his book that the three main types of credit risk are consumer risk, corporate risk and sovereign or country risk, while Culp and Neves (1998) cited in xiuzhu (2007) consider realized default risk and resale risk to be the two types of credit risk.

What is adopted here is part of the views from Horcher (2005) cited in xiuzhu(2007) who defines six types of credit risk, including default risk, counterparty pre-settlement risk, counterparty settlement risk, legal risk, country or sovereign risk and concentration risk. However, since legal risk is more likely to be considered as independent or belonging to operational risk nowadays and concentration risk, together with adverse selection as well as moral hazard, is more reasonably to be thought of as an important issue in managing credit risk rather than a type of the risk itself, in the following illustration, only the rest four kinds of credit risk mentioned by Horcher (2005) will be touched upon.



### **2.2.1 Default Risk**

According to Horcher (2005) cited in xiuzhu (2007) traditional credit risk relates to the default on a payment, especially lending or sales. And a likelihood of the default is called the probability of default. When a default occurs, the amount at risk may be as much as the whole liability, which can be recovered later, depending on factors like the creditors' legal status. However, later collections are generally difficult or even impossible in that huge outstanding obligations or losses are usually the reasons why organizations fail.

### **2.2.2 Counterparty Settlement Risk**

According to Girardone and Molyneux (2006) cited in xiuzhu (2007) settlement risk is a risk typically faced in the financial institutions market and it refers to the situation where one party to a contract fails to pay money or deliver assets to another party at the settlement time, which can be associated with any timing differences in settlement. Horcher (2005) cited in xiuzhu (2007) points out that the risk is often related with foreign exchange trading, where payments in different money centers are not made simultaneously and volumes are huge.

### **2.2.3 Country or Sovereign Risk**

Country risk arises due to the impact of deteriorating foreign economic, social and political conditions on overseas transactions and sovereign risk refers to the possibility that governments may enforce their authority to declare debt to external lenders void or modify the movements of profits, interest and capital under some

economic or political pressure Casu, Girardone and Molyneux (2006) cited in xiuzhu (2007). Then as Horcher (2005) cited in xiuzhu (2007) has concluded, since evidence shows that countries and governments have temporarily or permanently imposed controls on capital, prevented cross-border payments and suspended debt repayments etc, problems arise for issuers to fulfill obligations in such environment.

### **2.3 Managing Risk in Financial Institutions**

Risk management is a cornerstone of prudent financial institutions practice. Undoubtedly all financial institutions in the present-day volatile environment are facing a large number of risks such as credit risk, liquidity risk, foreign exchange risk, market risk and interest rate risk, among others – risks which may threaten a financial institution's survival and success. In other words, financial institutions are business of risk (A. Kanwar 2005). For this reason, efficient risk management is absolutely required. The purpose of financial institutions is to maximize revenues and offer the most value to shareholders by offering a variety of financial services, and especially by administering risks. Recently many financial institutions have appointed senior managers to oversee a formal risk management function their objectives (Thornton 2010).

#### **2.3.1 Credit Risk**

According to a risk management frame work for micro finance institutions of GTZ (released in2000) credit risk is the most frequently addressed risk for micro finance institutions is the risk to earning or capital due to borrowers late and non-payment of loan obligation.

Credit risk encompasses both the loss of income resulting from the micro finance institutions inability to collect anticipated interest earning as well as the loss of principal resulting from loan defaults. Credit risk includes both transaction risk and portfolio risk.

**A Transaction risk:** This is related to the individual borrower with which the MFI is transacting. A borrower may not be trustworthy and capable of repaying loan which will result in loss of loan. All loss of loan related to delinquency of individual clients which can be because client's migration, willful defaulting, business failure etc is called transaction risk.

**B. Portfolio risk:** Portfolio risk is related to factors, which can result in loss in a particular class or segment of portfolio. For example an MFI may lose a portfolio with a particular community, locality or a particular trade due to some external reasons. These reasons could be political, communal, failure of an industry /trade, etc.

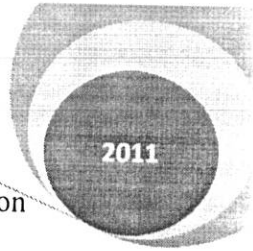
## **2.4 Causes of Credit Risk in MFI**

According to Macaver and O.Ehimare (undated) the source of credit risk can be either from borrower level or financial (lender) level.

### **2.4.1 Causes of Credit Risk at Borrower Level**

The causes of loan default at the borrowers' level include the following:

- ◆ Failure of investment to generate sufficient income due to improper technical advice, inadequate support services, marketing risks or natural disasters.



- ◆ Diversion of loan from desired objective operations to non-essential consumption which makes it difficult to meet repayment commitment on time.
- ◆ Existence of liabilities towards informal lenders, which may get precedence over institutional lenders, leading to delinquency and default.
- ◆ Contingencies at the borrower household, such as sickness, accident or death (pure risk).
- ◆ Operation at very low level of subsistence, forcing additional income generated through loan-supported activities to be appropriated for basic needs.
- ◆ Prevalence of low real rate of interest or pegging of interest rate far below the market rate.
- ◆ Absence of incentives for prompt repayment, or penalties for delayed repayment.

#### **2.4.2 Causes of Credit Risk at Financial Institution (Lender) Level**

At the financial institution level, loan default may be due to any or a combination of the following:

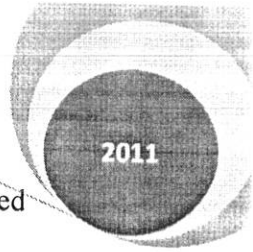
- ◆ Defective procedures for loan appraisal, which could lead to financing of bad projects, thereby giving rise to delinquencies and defaults.
- ◆ Quality of loan officers, their mobility in the field, and their capacity to judge borrowers as well as the incentive package available to them affect repayment. When loan officers are assessed more on the basis of compliance with lending targets than with recovery performance, it could lead to bad loans. When responsibility for lending and recovery are vested with separate officials in a credit agency, recovery tends to decline.

- ◆ Untimely loan disbursement and inappropriate repayment schedules. In addition, when the procedure for repayment is bulky, borrowers tend to default.
- ◆ Inability or reluctance of lenders to enforce sanctions against conspicuous defaulters.
- ◆ When institutions have limited contact with borrowers, default tends to increase. But when borrowers are in frequent contact and use several services of lenders, default reduces.
- ◆ Absence of sound accounting and management information system.

### **2.5 Managing Credit Risk**

Credit risk Management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks to ensure that; the individuals who take or manage credit risks clearly understand it, the organization's risk exposure is within the limits established by Board of Directors, risk taking decisions are in line with the business strategy and objectives set by BOD, the expected payoffs compensate for the risks taken, risk taking decisions are explicit and clear, sufficient capital as a buffer is available to take risk (Nagarajan 2001).

The acceptance and management of credit risk is inherent to the business of MFI as financial intermediaries (Nusselder 2003). Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk-reward trade -off.

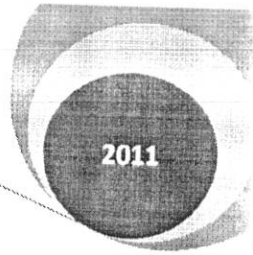


Despite the fact that MFIs are in the business of taking risk, it should be recognized that an institution need not engage in business in a manner that unnecessarily imposes risk upon it; nor it should absorb risk that can be transferred to other participants. Rather it should accept those risks that are uniquely part of the array of MFI's services (Nusselder 2003). The overall responsibility for risk management, which includes internal controls, rests with the board of directors. The board is responsible for ensuring that a formal risk assessment is undertaken at least annually for the purposes of making its public statement on risk management, including internal control. The board should acknowledge, in this statement, its responsibility for the risk management process and for reviewing its effectiveness.

Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day-to-day activities of the institutions (Thornton 2010).

### **2.5.1 The Principles of Credit Risk Management**

To review the general principles of credit risk management can provide a clearer picture on how financial institutions including MFI carry out their credit risk management. According to Basel (2000) the sound practices of financial institutions credit risk management should cover the following four areas as credit risk management principle:



### **A. Establishing an Appropriate Credit Risk Environment**

To establish an appropriate credit risk environment mainly depends on a clear identification of credit risk and the development of a comprehensive credit risk strategy as well as policies. To MFIs, the identification of existing and potential credit risk inherent in the products they offer and the activities they engage in is a basis for an effective credit risk management, which requires a careful understanding of both the credit risk characteristics and their credit-granting activities, especially the complicated or newly developed ones. Besides, the design of objective credit risk strategies and policies that guide all credit-granting activities is also the cornerstone in MFI credit risk management process.

### **B. Operating under a Sound Credit Granting Process**

A sound credit granting process requires the establishment of well-defined credit granting criteria as well as credit exposure limits in order to assess the creditworthiness of the obligors and to screen out the preferred one. MFI's credit criteria are designed to shape the types and characteristics of its preferred obligors, and they should set out who are eligible for the credit.

### **C. Maintaining Appropriate Credit Administration, Measurement and Monitoring Process**

Credit administration can play a vital role in the success of micro finance institutions, since it is influential in building and maintaining a safe credit environment and usually saves the institution from lending sins. Therefore, MFIs should never neglect the effectiveness of their credit administration operations.

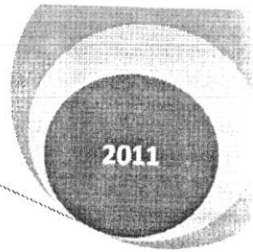
### **D. Ensuring Adequate Controls over Credit Risk**

The means for guaranteeing adequate controls over credit risk in MFIs lay in the establishment of different kinds of credit reviews. Regular credit reviews can verify the accordance between granted credits and the credit policies, and an independent judgment can be provided on the asset qualities.

#### **2.5.2 The Goal of Credit Risk Management**

The goal of credit risk management, as presented by the Basel (2000) is to maximize a financial institution's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters.

Consistent with principles of managing portfolio, it is requested that both the credit risk arising from individual creditors or transactions and the risk of the entire portfolio should be managed, and the relationship between credit risk and others must be considered as well.



## 2.6 Methods to Mitigate Credit Risk

According to Zoltan et al. (undated) the following are some of the methods that lenders can mitigate credit risk. Pavla Vodova (undated) also noted the following as a means of credit risk mitigation mechanisms.

**Risk-based pricing:** Lenders generally charge a higher interest rate to borrowers who are more likely to default, a practice called risk-based pricing. Lenders consider factors relating to the loan, such as loan purpose, credit rating, and loan-to-value ratio and estimates the effect on yield.

**Covenants:** Lenders may write stipulations on the borrower, called covenants, into loan agreements:

- ◆ Periodically report its financial condition.
- ◆ Refrain from borrowing further or other specific, voluntary actions that negatively affect the company's financial position.
- ◆ Repay the loan in full, at the lender's request, in certain events such as changes in the borrower's debt-to-equity ratio or interest coverage ratio.

**Tightening:** Lenders can reduce credit risk by reducing the amount of credit extended, either in total or to certain borrowers. For example, a distributor selling its products to a troubled retailer may attempt to lessen credit risk by reducing payment terms from *net 30* to *net 15*.

**Diversification:** Lenders to a small number of borrowers (or kinds of borrower) face a high degree of unsystematic credit risk, called concentration risk. Lenders reduce this risk by diversifying the borrower pool.

## **2.7 Collateral as a Means of Credit Risk Mitigation in MFI**

Collateral is a risk reduction tool, which, like many other such tools, mitigates risk by reducing credit exposure. The effect of collateralization is to substitute the credit risk of the issuer of the collateral for that of the counterparty to the transaction. Collateral reduces credit risk but gives rise to other forms of risk including legal, operational and concentration risk.

In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan (E. Condolff 2006). Anderson (2010) also noted that the collateral serves as protection for a lender against a borrower's default - that is, any borrower failing to pay the principal and interest under the terms of a loan obligation.

If a borrower does default on a loan (due to insolvency or other event), that borrower forfeits (gives up) the property pledged as collateral - and the lender then becomes the owner of the collateral.

Collateral, especially within MFIs, may traditionally refer to secured lending (also known as asset-based lending). More recently, complex collateralization arrangements are used to secure trade transactions.



### **2.7.1 Valuation of Collateral**

The valuation of the collateral provided by the credit applicant is an essential element in the credit approval process and thus has an impact on the overall assessment of the credit risk involved in a possible exposure. The main feature of a collateralized credit is not only the borrower's personal credit standing, which basically determines the probability of default (PD), but the collateral which the lender can realize in case the customer defaults and which thus determines the MFIs loss<sup>1</sup>.

### **2.8 Managing Credit Risk Using Financial Ratios**

Assessing a financial institution's management of credit risk reveals information about sustainability of operations. The analysis involves examining financial ratios related to loan quality. Future loss from loans that are not repaid is never certain. However, sound institutions have sufficient reserves of capital for potential losses (Huber 2010).

According to (Demerjian 2007) the following are the common financial ratios calculated to measure the credit risk of financial intuitions including micro finance institutions. These are portfolios at risk and repayment rate ratios.

Although credit risk is inherent to all loan of the MFI, it materializes in the loans which start showing overdues. An amount is called 'overdue' if it is not received by the MFI on its scheduled time.

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<sup>1</sup>-Source :(<http://free-books-online.org/finance-2/credit-risk-management-finance-2/credit-review-and-valuation-of-collateral-cont/>)

Every loan that an MFI provides have fixed schedule for repayment. This is called Repayment schedule, which provides the schedule of payment and acts as the reference point for the MFIs to estimate their overdues.

At the time of loan disbursement every client is given a repayment schedule, which shows the amount to be paid in each installment and the date of payment. If the amount is not received on or before the schedule date it is called overdue. If any loan has any amount overdue it is termed as a Delinquent loan or a case of delinquency (Demerjian 2007).

MFIs try to have an objectives view of their credit risk and want to measure the extent of credit risk, which is the risk on their portfolio. There are various indicators, which help in measuring the credit risk profile of an MFI. Of these indicators portfolio at risk or commonly known as PAR is considered to be the most effective and is now very common indicator across MFIs. Apart from PAR, Repayment rate is other ratio, which also provides information about the portfolio quality of an MFI (Demerjian 2007).

**PAR; Portfolio at risk** tries to measure the amount of loan outstanding that the MFI stands to lose in case an overdue client does not pay a single installment from the day of calculation of PAR. PAR is the proportion of loan with overdue clients to the total loan outstanding of the organization.

$$PAR = (Loan\ outstanding\ on\ overdue\ loans / Total\ loan\ outstanding\ of\ the\ MFI) \times 100$$

**Repayments rate;** Repayment rate on the other hand is the ratio of the amount received by the organization against the total amount due.

$$\text{Repayment rate} = (\text{Total principal collection during a period} - \text{prepayments}) / \text{Total amount due for the period} \times 100$$

Prepayments, if any have to be deducted from the collections, as this amount was not due for the period. Prepayment is the principal amount paid by clients before it was due. As mentioned earlier, all these ratios, MFIs and financial institutions lay maximum emphasis on PAR and consider it as the best indicator for risk. This is because PAR is a forward looking ratio and provides an estimate of the total loss that an MFI is likely to make should the risky clients default. While repayment rate only provide information of current loss and indicate the past performance. Repayment rate is not able to capture the future risk.

## 2.9 Components of Credit Risk Management

According to the risk management guidelines for commercial banks & other financial institutions in Pakistan, A risk management frame workformicrofinanceinstitutions(GTZ,1999and,2000),Nancy et al. and Bruett(2001),principles for the management of credit risk Basel committee(2000), Credit Institutions Regulatory Document Impairment Provisions for Credit Exposures(Irish financial service authority 2005),guide lines on credit risk management for financial institutions prepared by eastern caribbean central bank(released in 2009),appraisal guide for microfinance institutions<sup>2</sup>

<sup>2</sup> Appraisal Guide for Microfinance Institutions: A Technical Guide is

(Isern et al. 2008) in their writing stated that typical credit risk management framework in a financial institution may be broadly categorized into following main components<sup>3</sup>.

- a) Board and senior Management's Oversight
- b) Organizational structure
- c) Systems and procedures for identification, acceptance, measurement, monitoring and control risks.

### **2.9.1 Board and Senior Management's Oversight**

It is the overall responsibility of Board to approve institution's credit risk strategy and significant policies relating to credit risk and its management which should be based on the institution's overall business strategy. To keep it current, the overall strategy has to be reviewed by the board, preferably annually.

The responsibilities of the Board with regard to credit risk management shall include:

- a) Explain institution's overall risk tolerance in relation to credit risk.
- b) Ensure that institution's overall credit risk exposure is maintained at prudent levels and consistent with the available capital.
- c) Ensure that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge to accomplish the risk management function.

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available for download from the CGAP Web site  
(<http://www.cgap.org/>) publications page.

<sup>3</sup> The researcher believed that this comprehensive and organized credit risk management component and guidelines can be effective to Ethiopian financial institutions including micro finance institutions.



- d) Ensure that the institution implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk.
- e) Ensure that appropriate plans and procedures for credit risk management is in place.

### **2.9.2 The Responsibilities Senior management**

The senior management of the institutions should develop and establish credit policies and credit administration procedures as a part of overall credit risk management framework and get those approved from board. Such policies and procedures shall provide guidance to the staff on various types of lending including corporate, SME, consumer, agriculture, etc.

At minimum the policy should include

- a) Detailed and formalized credit evaluation/ appraisal process.
- b) Credit approval authority at various hierarchy levels including authority for approving exceptions.
- c) Risk identification, measurement, monitoring and control
- d) Risk acceptance criteria
- e) Credit origination and credit administration and loan documentation procedures.
- f) Roles and responsibilities of units/staff involved in origination and management of credit.
- g) Guidelines on management of problem loans.



### **2.9.3 Organizational Structure.**

To maintain MFI overall credit risk exposure within the parameters set by the board of directors, the importance of a sound credit risk management structure is required. While the MFIs may choose different structures, it is important that such structure should be commensurate with institution's size, complexity and diversification of its activities. It must facilitate effective credit risk management oversight and proper execution of credit risk management and control processes.

Each MFI, depending upon its size, should constitute a Credit Risk Management Committee (CRMC), ideally comprising of head of credit risk management Department, credit department and treasury. This committee reporting to institutor's risk management committee should be empowered to oversee credit risk taking activities and overall credit risk management function.

The CRMC should be mainly responsible for:

- a)* The implementation of the credit risk policy / strategy approved by the Board.
- b)* Monitor credit risk and ensure compliance with limits approved by the Board.
- c)* Recommend to the Board, for its approval, clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks.



- d)* Decide delegation of credit approving powers, prudential limits on large credit exposures, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance, etc.

Further, to maintain credit discipline and to enunciate credit risk management and control process there should be a separate function independent of loan origination function. Credit policy formulation, credit limit setting, monitoring of credit exceptions / exposures and review /monitoring of documentation are functions that should be performed independently of the loan origination function. To do so the MFI should institute a Credit Risk Management Department (CRMD).

Typical functions of CRMD include:

- a)* To follow a holistic approach in management of risks inherent in MFIs portfolio and ensure the risks remain within the boundaries established by the Board or Credit Risk Management Committee.
- b)* The department also ensures that business lines comply with risk parameters and prudential limits established by the Board or CRMC.
- c)* Establish systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning. The department would work out remedial measure when deficiencies/problems are identified.
- d)* The Department should undertake portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.

#### **2.9.4 Systems and Procedures for Identification, Acceptance, Measurement, Monitoring and Control Risks.**

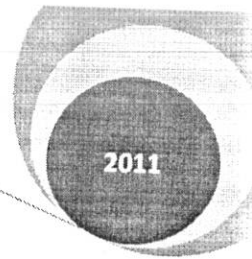
Micro finance institutions must operate within a sound and well-defined criteria for new credits as well as the expansion of existing credits. Credits should be extended within the target markets and lending strategy of the institution. Before allowing a credit facility, the MFI must make an assessment of risk profile of the customer/transaction.

This may include

- a)* Credit assessment of the borrower's industry, and macro economic factors.
- b)* The purpose of credit and source of repayment.
- c)* The track record / repayment history of borrower.
- d)* Assess/evaluate the repayment capacity of the borrower.
- e)* The Proposed terms and conditions and covenants.
- f)* Adequacy and enforceability of collaterals.
- g)* Approval from appropriate authority

#### **2.9.5 Credit Administration.**

Ongoing administration of the credit portfolio is an essential part of the credit process. Credit administration function is basically a back office activity that support and control extension and maintenance of credit.



A typical credit administration unit performs the following functions:

- a. Documentation.** It is the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt.
- b. Credit Disbursement.** The credit administration function should ensure that the loan application has proper approval before entering facility limits into computer systems. Disbursement should be effected only after completion of covenants, and receipt of collateral holdings. In case of exceptions necessary approval should be obtained from competent authorities.
- c. Credit monitoring.** After the loan is approved and draw down allowed, the loan should be continuously watched over. These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.
- d. Loan Repayment.** The obligors should be communicated ahead of time as and when the principal/mark up installment becomes due. Any exceptions such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt.
- e. Maintenance of Credit Files.** Institutions should devise procedural guidelines and standards for maintenance of credit files. The credit files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess financial health of the borrower and its repayment performance.



It need not mention that information should be filed in organized way so that external / internal auditors or SBP inspector could review it easily.

**f. Collateral and Security Documents.** Institutions should ensure that all security documents are kept in a fireproof safe under dual control. Registers for documents should be maintained to keep track of their movement. Procedures should also be established to track and review relevant insurance coverage for certain facilities/collateral. Physical checks on security documents should be conducted on a regular basis.

#### **2.9.6 Credit Risk Monitoring & Control**

Credit risk monitoring refers to incessant monitoring of individual credits inclusive of Off Balance sheet exposures to obligors as well as overall credit portfolio of the MFI. MFIs need to articulate a system that enables them to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable a institutions to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance of regulatory limits. Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends. Consequently the management could fine tune or reassess its credit strategy /policy accordingly before encountering any major setback.

The MFIs credit policy should explicitly provide procedural guideline relating to credit risk monitoring.

At the minimum it should lay down procedure relating to:

- a) The roles and responsibilities of individuals responsible for credit risk monitoring
- b) The assessment procedures and analysis techniques (for individual loans & overall portfolio)
- c) The frequency of monitoring
- d) The periodic examination of collaterals and loan covenants
- e) The frequency of site visits
- f) The identification of any deterioration in any loan

### **2.9.7 Credit Analysis**

Credit analysis is geared toward one decision; does the FI grant the loan? The purpose of credit analysis is to generate profitable loan that do not expose the lender to excessive amount of risk. The reason for the acceptance or reject decision should be clearly documented and the decision should be in accordance with the MFIs stated loan policy. Criteria used must not be discriminatory these the determinant of the decision cannot be race gender location ethnicity or religious persution. In the long run it will cost the lender much more to handle a failed loan than to incorrectly turn down a loan that would not have failed. This is true because lending has asymmetric out comes. Distribution of returns on loans exhibits negative skewness. Lowering credit quality tends to increase the negative skegness although if the risk is priced this may also increase the average rate of return on the loan portfolio. Regulators impose quality standards on lender to help ensure they do not take on too much risk in attempting to increase the average return on the loan portfolio.



The MFIs loan policies include the desired portfolio of loan by category and include minimum credit standard such as collateral requirements and minimum ratios. Other provisions include lending limits for certain loan officers positions, standards for grading loan, requirements for monitoring existing loan ,policies on inside loan and the documentation required to evaluate a loan applications.

## **2.10 Microfinance Institutions in Ethiopia**

It is believed that the provision of micro credit to poor households would increase their assets and income. As a result, microfinance credit is considered as one of the methods of alleviating poverty. Since in the mid- 1980s, many non-governmental organizations (NGO) in Ethiopia have started providing micro- credit to poor households for income generating activities (Michael 2006). Moreover, the development bank of Ethiopia, in collaboration with the ministry of trade, has launched a micro enterprise lending program (Kereta 2007). Since 1994, recognizing the importance of microfinance facility, the present government issued a proclamation that laid down the framework for licensing and supervision of the business of microfinance institutions (MFIs) in July 1996, through Proc. No. 40/1996.

The objectives of the proclamation were:-

- (a) To provide a legal framework that brings monetary and financial policies and
- (b) To provide a legal framework for the promotion of MFIs. The proclamation allows MFIs to undertake both financial and non-financial activities. The licensing and supervision of MFIs enhanced the status of MFIs as it authorized them to, among many other things, legally accept deposits from general public (hence diversify their sources of fund), draw and accept deposits, and manage funds for Micro Finance businesses. According to the association of Ethiopian microfinance report (released in 2011) currently there are 28 MFIs operating throughout the country licensed under the national bank of Ethiopia. Among these institutions eighteen (18) MFIs are currently operating in the city of Addis Ababa with different branches throughout the country.

## **2.11 Empirical Review**

Within the last few years a number of studies have provided the discipline into the practice of risk management and other issue of micro finance institutions. An insight of related studies is as follows:

Nawai and Shariff (2010) in their study found that close and informal relationship between MFIs and borrowers help in monitoring and early detection of problems that may arise in non-repayment of loans that finally lead to credit risk. In addition, cooperation and coordination among various agencies that provide additional support to borrowers may help them success in credit risk management in their business. Method used is that quantitative research method.

Laurentis and Mattei (2009) conducted research on Lessors' recovery risk management capability and found that the development of modern reliable systems of risk management can enhance even more those management capabilities. This means that credit institutions should invest significant resources in projects aimed at correctly implementing rating systems and credit risk models, and highlights once more the importance of these tools well beyond the scope of regulatory compliance. The research method used is that mixed research method.

Paul et al.(2001) in their study of viewing micro insurance as a social risk management instrument examined that there should be efficient and equitable risk management for micro finance institutions through micro insurance since micro insurances has positive impact on effective credit risk management.

The study also noted that it is clear that micro insurance may be an acceptable means of managing some forms of risk, but not all in micro finance institutions. Method used is qualitative research method.

Chua et al. (2000) conduct research on microfinance, risk management, and poverty indicated that the relationship between risks to the client and risks to the loan portfolio has been largely important to the microfinance industry. This is because a more explicit recognition of this relationship in the design of products and services can reduce both the risk of borrowing for clients and the risk of lending for MFIs. Products, services, and delivery mechanisms that are designed to improve the capacity of clients to deal with risk in their lives (reduce their vulnerability) and to reduce the risk of taking a loan can lead to better repayment, fewer dropouts, and, accordingly, lower operating costs. Research method used in the study is that quantitative research method.

Nagarajan (2001) in his study of risk management for microfinance institutions in Mozambique found that risk management is a dynamic process that could ideally be developed during normal times and tested at the wake of risk. It requires careful planning and commitment on part of all stakeholders. It is encouraging to note that it is possible to minimize risks related losses through diligent management of portfolio and cash-flow, by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders during the normal times and through choice of relevant products and strategies to mitigate and cope with risk. Method used by researcher is qualitative research method.

Peterson and Bohman (2008) in the study of credit risk management system of a commercial bank in Tanzania examined that the financial intuitions well-documented credit risk management policy that elaborates the products offered and all activities play an important role to manage the credit risk. The institutions well organized credit manual that documents and elaborates the strategies for managing credit risk also the part of effective credit risk management and they have to formulate in compliance with the institutions credit policy. Strategies for granting credits also should focus on whom, how and what should be done at the branch and corporate division levels while assessing borrowers. Quantitative credit scoring models should be part of credit risk management mechanisms. Method used was quantitative research method.

Bhatia (2004) made research on mitigating currency risk for investing in microfinance institutions in developing countries found that there is a clear tradeoff for investors mitigating currency risk in list developed countries in the form of contract fees for the benefit of protection against currency fluctuations. The best financial instrument for investors interested in MFIs is currency options. Before selecting a hedge, investors must thoroughly evaluate the level of currency risk for the respective developing country and the cost-benefits of a hedged versus un-hedged investment. Method used to conduct the study is mixed research method.

Achou and Tenguh (2008) also conduct research on bank performance and credit risk management found that there is a significant relationship between financial institutions performance (in terms of profitability) and credit risk management (in terms of loan performance). Better credit risk management results in better performance.

Thus, it is of crucial importance that financial institutions practice prudent credit risk management and safeguarding the assets of the institutions and protect the investors' interests. This is also true for micro finance institutions. Method used by the researchers is mixed research method.

Wenner et al. (2007) conduct research on managing credit risk in financial institutions in Latin America. In their study they found that donors and governments can assist in the capture and dissemination of relevant information that would serve to reduce asymmetries that contribute to credit risk. High quality and functioning databases would help to facilitate better risk measurement, better risk modeling, and the design of credit, savings, and insurance products. Method used was qualitative research method.

Ahmed (2007) in the study of micro finance: realizing the social role of Islamic finance examined that the MFI has to create various reserves to cover various risks arising due to the nature of its assets and liabilities since it positively contribute to risk management in micro finance institutions. To protect from withdrawal risks, the MFI can use profit-equalization reserves to give depositors competitive returns. Method used was qualitative research method.

Hudon (2006) in his study of subsidies and financial performances of the microfinance institutions: Stated that financial institutions including micro finance institutions still exhibit better management ratings. The technical, organizational and communication competences of the top managers are the most important management dimensions to explain all financial results. Under this dimension of management, the professional skills of the top managers that must be emphasized. Therefore the institutions will be effective in credit risk management performance. Method used by researcher is qualitative research method.

Zinman (2007) in their study of credit elasticity in less-developed economies: Implications for microfinance found that operationally feasible increases in maturities could have large effects on aggregate credit flows in markets where liquidity constraints bind. Method used is qualitative, and the sample frame consisted of all individuals from 86 predominantly urban branches who had borrowed from the Lender within the past 24 months, were in good standing, and did not currently have a loan from the Lender as of thirty days prior to the mailer. Method used was quantitative research method.

Thierry van Bastelaer (2000) in his study of imperfect information, social capital and the poor access to credit found that well-documented inter-borrower relations and quality of the relation between the borrowers and the lender organization's staff plays an important role in credit risk management. Method used is qualitative research method.

A. Fernand (undated) conduct research study on managing microfinance risks: some observations and suggestions stated that risk management has become more important now and its importance will continue to grow in the future. Factors such as the increasing competition in markets and the integration of new technology into the industry further reinforce the importance of microfinance risk management. The growing interest of MFIs further reinforces the importance of risk management in MFIs. However, it is disturbing to note that systematic risk management is still not as widespread as it should be. The increased emphasis on microfinance risk management at the level of international promoters of microfinance has not yet had its full impact on most institutions at the retail level. Method used was mixed research method.

In Ethiopia, the studies by Wolday (2001), Befkadu (2007), Zigju (2008), Michael (2006) and Samuel (2006) focus on progress of micro finance institutions in terms of number of clients, loan amount and number of branches throughout the country. The studies by Michael (2006) and Samuel (2006) tries to touch the issue of credit risk management in some micro finance institutions in Ethiopia but they did not assess exhaustively the performance of micro finance institutions in credit risk management.

The empirical studies that have been reviewed in the preceding section focused on the different micro finance institutions issues that affect the performance of micro finance institutions. In addition, most prior studies regarding credit risk management tried to examine the possible methods to manage credit risk including the use of credit score rating, and the impact of borrower's financial positions on credit risk management.

However to the knowledge of the researcher, it is possible to concluded that although there have been a number of studies on credit risk management and related issues both in developed and developing countries, Ethiopia in particular, there are no studies that exhaustively examine the credit risk management practice of micro finance institutions specially in Ethiopia.

As a result, this study were designed to fill the aforementioned gaps and provide concluding recommends having the main objective of analyzing and examining the performance of sample micro finance institutions in credit risk management in Addis Ababa.

## **Chapter Three**

### **3.1 Research Design**

Research design is specific research methodology, philosophies and techniques used to achieve the objectives of the study. It encompasses philosophies and techniques used in choosing alternative research methodology and technique issues, sources of data, sampling plan and methods of data collection and analysis. The research approaches and methods of data collection and analysis that were used in this study are discussed in the following sub-sections.

### **3.2 Research Approaches Used in the Study**

There are three alternative strategies of inquiry: qualitative, quantitative and mixed approaches. In order to achieve the research questions stated in the previous section, the researcher used both qualitative and quantitative approach (mixed approach) in collecting and analyzing data. The selection of one over the other approach for the conduct of the study is based on the research problem (issue or concern that needs to be addressed), the researcher's own personal experience and the will and support of the audiences (Creswell 2009).

### **3.3 Sample Population and Sampling Techniques**

#### **3.3.1 Sample population**

The researcher incorporates all the micro finance institutions in Ethiopia as the study population. According to Association of Ethiopian micro finance institutions (AEMFI) currently there are twenty eight (28) micro finance institutions in Ethiopia.

#### **3.3.2 Sampling frame**

The researcher considers those micro finance institutions with head office in Addis Ababa as sample frame. Out of the 28 micro finance institutions in Ethiopia 18 are found in Addis Ababa.

#### **3.3.3 Sampling Size.**

The researcher consider out of the total 18 micro finance institutions in Addis Ababa five micro financial institutions were approached in the study.

A sample of these micro financial institutions in Addis Ababa are selected using purposive sampling in the sense that the study was select a sample believed to deliver the best information regarding the performance of selected micro finance institutions in credit risk management particularly information in relation with Loan repayment performance, collateral valuation and security documentation, credit disbursement practice, credit monitoring system ,maintenance of credit Files and identification of financial position and business conditions of borrower and other related information to the study area. The researcher believed that those institutions which are established in early time provide more comprehensive and organized data or information on the study area.

### **3.4 Methods of Data Collection**

Research methods are the technique used to collect data. In this study, the researcher used mixed methods approach, which are employed concurrently in collecting and analyzing data. There are different tools available to the researcher to collect the required data including questionnaires, observation, interview, and document analysis. For this study, the researcher was apply quantitative (survey) and qualitative (semi-structured interview and document analysis), and are discussed in the following sub-sections.

#### **3.4.1 Quantitative aspect: Survey**

Survey design is a research method that provides a quantitative or numeric description of trends, attitudes, or opinions of participants with the intent of generalizing from a sample to a population (Creswell 2009). Typically, surveys gather data at a particular point in time with the intention of describing the nature of existing conditions, or identifying standards against which existing conditions can be compared, or determining the relationships existed between specific events (Cohen et al. 2000).

As Weisberg et al. (1996) cited in Cohen et al. (2000) stated, surveys are useful to gather factual information and data on attitudes, preferences, beliefs, predictions, behavior and experiences.

Survey research has its own strengths and weaknesses. The strengths of survey research include; highly flexible, possibly cover a wide range of research questions, describe an existing situation, easy to guarantee respondents anonymity (for instance, questionnaires may lead to more honest answers), easier to

generalize findings, and efficient in gathering large amounts of data at reasonably low cost and effort.

The limitations include that it is difficult to come to deeper understanding of processes and contextual differences through questionnaires, which are standardized and by their nature limited in length and depth of responses (Muijs 2004).

This thesis has an objective of describing the performance of some micro finance institutions in credit risk management. Thus, survey method of quantitative approach is appropriate and was employed for this study. Descriptive statistics analysis is used.

#### **3.4.1.1 Survey Instruments**

Survey instruments include self-administered questionnaire, structured interview and structured observations (Creswell 2009). This study was used questionnaire, which is a widely used and useful instrument for collecting survey information. As Wilson and McLean (1994) stated, questionnaire provide structured information, being administered without the presence of the researcher, and often comparatively straightforward to analyze.

Questionnaire as a tool for data collection has its own advantages and limitations.

The advantages found from the literature includes that the data collected through the use of questionnaire are efficient, reliable because of anonymous, honest, economical (in terms of time and money), quick (even possibly mailed), consistent (little scope for bias), offers the possibility of standardizing and comparing scales, and enables the anonymity of the data sources to be preserved.

Nevertheless, the major limitations are nonflexible (no longer possible to backtrack once the administration phase is under way), lack of qualitative depth,

The questionnaires are distributed to 60 purposively selected employees of selected micro finance institutions specifically to those employees that considered of having better understanding about credit risk management practice (i.e loan officers or credit officers and general managers and branch manager, operation manager and operation officers, auditors, finance managers and others like accountant and MIS officers in head office and branch of Addis Ababa). The questionnaires are distributed equally to five selected micro finance institution in Addis Ababa. That is 12 questionnaires are distributed to each selected micro finance institutions employees.

### **3.4.2 Qualitative aspect: Semi-structured Interview and Documentary**

#### **Analysis**

Qualitative research is used to describe or explain what is happening within a study area. Qualitative method mainly includes three kinds of data collection: in-depth interview, direct observation and written documents (Patton 2003). For this study, data was collected through semi-structured interview and documentary analysis.

#### **3.4.2.1 Semi-structured Interview**

An interview is a purposeful discussion and/or conversation with two or more people, and helps the researcher to gather valid and reliable data that are relevant to achieve research questions and objectives. Interviews may be structured (using standardized questions for each respondent), semi-structured, and unstructured conversations (Saunders et al. 2003). Structured interview uses pre-established questions, asked in a predetermined order, using a standard mode of delivery.

On the other hand, unstructured interview attempts to draw out information, attitudes, opinions, and beliefs around particular themes, ideas, and issues without the aid of predetermined questions (Leary 2004).

As Dowson (2002) noted, semi-structured interview helps the researcher to utilize the advantage of both structured and unstructured interview, so that the interview remains flexible and other important information can still arise. It is perhaps the most common type of interview used in qualitative social research, where the researcher wants to know specific information that can be compared with information gained in other techniques (Dawson 2002).

This study used semi-structured interview to explore the data that is unclear for the researcher and the information that are not be collected through survey and document analysis. The interview was made with operation manager or credit officers of the respective institutions.

#### **3.4.2.2 Documentary Analysis**

Document analysis is the collection review, interrogation, and analysis of various forms of text as a primary source of research data. It refers to both a data collection method and a mode of analysis (Leary 2004).

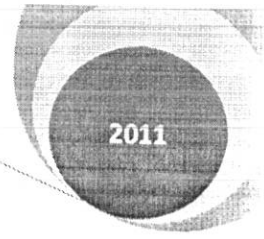
Document analysis is a tool that may be conducted using documents such as written materials, organizational or program records, official publications and reports, news papers, a minutes of meeting, and personal documents (diaries, artistic works, letters, photographs and journals) (Patton 2003).

As Creswell (2009) noted, use of documentary analysis has its own strengths and limitations.

The strengths are enables the researcher to obtain the language and words of participants, can be accessed to the researcher at a time conveniently, represents data which are thoughtful (participants given attention when compiling them), and economical (it saves the time and expense of transcribing). Whereas, the limitations include incompleteness, lack of accuracy (the documents may not be authenticated), requires transcribing or optically scanning for computer entry, not all people are equally articulate and perceptive, and may be protected from private access. In addition to the data obtained through other methods, this study employ a descriptive analysis of documents mainly documents in relation to calculation of portfolio at risk rate(PAR) and repayment rate since they are the main ratios that every microfinance institutions used as credit risk management techniques. Therefore data in relation with these two ratios were obtained and analyzed. The three years (i.e 2008-2010) data for the calculation of these ratios was collected from the respective institutions.

### **3.5 Analysis Method**

Both quantitative and qualitative data analysis method were used .Based on the nature of the data collected through questionnaires, interview and policy manuals and documents, the following procedures and statistical tools were employed. The data that is going to collect through questionnaires and data collected from different document in the institutions were tabulated and analyzed using the SPSS software package these includes mean and standardelevations. Descriptive stastics were used to analyze data. Furthermore, descriptions were made based on the results of the tables. The results that are obtained from the interview were used for strengthening the analysis of the questionnaires.



## **Chapter Four**

### **Data Presentation and Analysis**

The interpretation and analysis is done in two parts. Part one of the interpretations is organized and analyzed in such a way that response for closed ended question and other secondary quantitative data are presented for discussion using tabular (percentage) method of data analysis.

#### **4.1 Presentation and Analysis of Quantitative Data**

In order to give an over view of the general back ground of the respondents involved in the study ,factors such as sex,age and educational level are discussed in table one in the next page and the other quantitative data from questionnaires are discussed next to respondents profile.

Table1: Demographic Profile of Respondents

Item	frequency	Percent
<b>Sex</b>	Frequency	Percent
Male	37	63.8
Female	21	36.2
Total	58	100
<b>Age</b>	Frequency	Percent
<25	2	3.4
25-35	39	67.2
35-50	17	29.3
>50	0	0
Total	58	100
<b>Educational level</b>	Frequency	Percent
Grade 10/12 completed	0	0
Certificate	1	1.7
Diploma	35	60.3
Degree	21	36.2
Above degree	1	1.7
Total	58	100

Sources: Questionnaires result

As shown in table1 above out of the total 58 respondents 63.8% of them were male and the remaining 36.2% were female. Regarding with the age of respondents out of the total respondents 3.4% of them were below 25 years, 67.2% were between 25-35 years. On the other hand 29.3% were between 35-50 years. Concerning the educational level of respondents the majority of respondents (60.3%) are diploma holders and 36.2% are first degree holders and finally 1.7% are certificate and the remaining 1.7% are above degree.



### 4.1.2 Questioners Analysis

All of the five sample institutions were answered in this questionnaire. The researcher analyses the questionnaire for all of the institutions together since the respondents answered in a similar fashion for identical questions.

**Table2: Credit Risk Management System**

Questions	N	Mean	Std.Deviation
Q1-There is clear description of the methodology for assessing credit risk;	58	3.90	.912
Q2-There is efficient and effective internal credit quality reviews;	58	2.88	1.215
Q3-There is a common understanding of credit risk management across the institutions	58	2.69	1.158

Sources: Questionnaires result

Note. N: number of respondents

The literature noted that in order to have effective credit risk management the micro finance institutions should have clear communication of methodology and procedures which is very important in credit risk management process. If the clients do not know the methodology and procedures how credit is assessed it can result in confusion and delinquencies even if clients are capable of paying.

In this regard the mean response of survey is above 3.00 (i.e 3.90 or near 4.00) and standard deviation is less than 1.00 (i.e 0.912) (seeTable2) which indicated on average the respondents were agreed that there is clear description of the methodology for assessing credit risk in the institutions.

Regarding the presence of efficient and effective internal credit quality reviews the mean response were less than 3.00 i.e 2.88 and the standard deviation is greater than 1.00 i.e 1.215 (see Table2). In this regard the literature noted that adequate controls over credit risk in MFIs lay in the establishment of different kinds of credit reviews. Regular credit reviews can verify the accordance between granted credits and the credit policies, and an independent judgment can be provided on the asset qualities.

Having this theory the mean response of this question (i.e Q2) indicates on average respondents are disagreed to this specific question since the mean response is less than 3.00. Finally we can conclude that the institutions experience in credit quality review is not as such satisfactory.

To maintain credit discipline and to pronounce credit risk management and control process there should be common understanding of credit risk management across the institutions. This may help for check and balance and to identify source of credit risk easily across the institutions. At the same time if there is common understanding about credit risk management across all institutions the probability of occurrence of credit risk is minimal since the institutions become aware of the risk before it occurred. In connection with this question (i.e Q3) the response mean from the survey is 2.69 that is less than 3.00 and the standard deviation is 1.158 that is more than 1.00(see Table2). This shows that on average the respondents were disagreed to this specific question (i.e Q3). Finally this data indicates that the respondent's perception was far away to one another and there is no common understanding across the institutions about credit risk management.



**Table3: Board Oversight in Credit Risk Management**

Questions	N	Mean	Std.Deviation
Q4-Board ensure that MFI's overall credit risk exposure is maintained at prudent levels and consistent with the available capital	58	3.05	1.050
Q5-Board Ensure that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge to accomplish the risk management function	58	2.64	1.119
Q6-Board Ensure that the MFI implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk.	58	3.22	1.060
Q7-Board Ensure that appropriate plans and procedures for credit risk management are in place.	58	3.45	1.157

Sources: Questionnaires result

Note. N: number of respondents

The goal of credit risk management is to maximize a financial institution's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. If the credit risk exposure of the institutions is greater than the institutions capital the institutions are unable to manage their credit risk. In connection with this the mean response of the survey is 3.05 and the standard deviation is around 1.00 i.e 1.05(see Q4 in Table3).

This revealed that on average the respondents demonstrated neutrally to the issue of board ensure that MFI's overall credit risk exposure is maintained at prudent levels and consistent with the available capital.

The other question (Q5) is that about whether board ensure that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge or not to accomplish the risk management function.

In this regard the response mean is below 3.00 and the standard deviation is above 1.00 (see Table3). This means on average the respondents gives their witness by saying we are disagreeing to this specific question that is on average majority of respondents believed that staffs involved in credit risk management issue do not possess the required knowledge. However in this regard the theory noted that it is the overall responsibility of staffs (particularly employees organized as a board member of the institutions) to approve the institution's credit risk management strategy and significant policies relating to credit risk management. To do so institutions board should ensure that top management as well as individuals responsible for credit risk management possesses sound and expertise knowledge to accomplish the credit risk management function successfully. But the result of the survey shows that the institutions board is not effective in doing so.

On the other hand the mean response of the last two questions (Q6 and Q7) in the above table under board oversight in credit risk management were more than 3.00 and the standard deviations for these questions is more than 1.00 (see Table3). This indicates that the perception of the respondents were far away one another to these two questions.



In this regard the literature explained that MFIs need to articulate a system that enables them to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs.

Such a system would enable institutions to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance of regulatory limits.

Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends. Finally even though the standard deviation is more than 1.00 it is not far from 1.00 and since the mean response is more than 3.00 we can say that the institutions have somewhat good principle, plan and procedures to manage and monitor credit risk. However it is not as such strong enough.

**Table4: The Institution’s Credit Risk Management Strategy**

Questions	N	Mean	Std.Deviation
Q8-The institution’s plan to grant credit based on various client segments and products, economic sectors, geographical location, currency and maturity	58	3.93	.876
Q9-The institution carries out a comprehensive and systematic identification of its risks relating to each of its declared aims and objectives	58	3.71	1.076

Sources: Questionnaires result

Note . N:number of respondents

Poor choice of clients results in delinquencies (default risk). If client with bad reputation or history of defaults are selected then it can result in delinquencies or credit risk. Therefore to minimize the probability of occurrences of this delinquencies micro finance institutions should give special attention for their practice of selecting their customer before they are giving loan to clients. In this regard the mean response in the above table (Q8) shows that as 3.93 i.e above 3.00 and the standard deviation less than 1.00 which indicates that the respondent's perception is close to one another. Therefore on average the respondents agree that the institutions are effective in client segmentation before they are going to grant loan to these clients. The other question under credit risk management strategy in the above table is about risk identifications (i.e Q9).

In connection with this question the literature stated that organized, comprehensive and systematic identification of risk is the task that micro finance institutions should perform. This is because if the institutions are not capable of identifying what risk they face in the future they are not capable of designing effective and technical credit risk management methodology. In this regard the survey mean response is above 3.00 i.e around 3.7 (near 4) and the standard deviation is around 1.00 i.e 1.076 (see Table4) which indicates that the respondents perception is far away to one another. This reveals on average respondents are agreed that institutions experience in risk identification is good but not strong enough.

**Table5: Responsibility of Senior Management of the Institutions in Policy**

**Designing of Credit Risk Management**

Questions	N	Mean	Std.Deviation
Q10-There is Detailed and formalized credit evaluation/appraisal process that can be easily understandable by borrower.	58	4.03	.973
Q11-Risk acceptance criteria are clearly stated in the institutions loan policy.	58	3.91	1.014
Q12-there is clear and easily understandable Credit origination and credit administration and loan documentation procedures.	58	4.03	.674
Q13-Ensure that all collateral held by the credit institution in addition to available for sale financial assets, are appropriately valued by personnel independent of the credit origination function;	58	2.76	1.189

Sources: Questionnaires result

Note .N: number of respondents

As GTZ risk management frame work in micro finance institutions (released in 2000) noted that delinquencies can happen as a result of poor credit evaluation process by the institutions themselves. Those micro finance institutions that have strong enough credit evaluation practice can control credit risk to a large extent.

Therefore this strong credit evaluation process gives clear message to the clients that the micro finance institutions are serious on repayments and thus prevents the future occurrences credit risk. In this regard the mean response is more than 3.00 and the standard deviation is less than 1.00 (see Q10 in Table5). This indicates that the respondents perception were close one another.

From this one can understand that on average the respondents are agreed that the institutions senior management is effective in designing detailed and formalized credit evaluation/ appraisal process that can be easily understandable by borrower which can minimize the probability of occurrence of credit risk in the institutions.

The other responsibility of senior management in relation to credit risk management is stating risk acceptance criteria in the loan policy of the institutions. In this regard the theory noted that MFIs are in the business of taking risk, it should be recognized that an institution need not engage in business in a manner that unnecessarily imposes risk upon it nor it should absorb risk that can be transferred to other participants. Rather it should accept those risks that are uniquely part of the array of MFI's services. To attain this objective the institutions should have risk acceptance criteria that clearly stated in their loan policy. Having this fact the survey indicates that the mean response is around 3.91 (near 4) i.e above 3.00 and the standard deviation is around 1.00 i.e 1.014(see Q11 in Table5) which indicates on average respondents were agreed to this specific question (i.e Q11). Finally from the survey result we can understand that the senior management does better in identifying and setting risk acceptance criteria.

The other issue that should get attention by the senior management of the institution is the preparation of loan administration and documentation procedures. According to the theory or literature it is the responsibility of credit administration to ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt. Any micro finance institutions fail to do so may not survive in the long run.

The researcher survey in this regard indicated that the mean response is around 4.00 and the standard deviation is less than 1.00 i.e 0.674 (see Q12 in Table5) which indicates that the respondents perception were close to one another. So from the survey one can learn that on average the respondents were agreed that the senior management is effective in designing well organized credit administration and loan documentation procedures.

The senior management is also responsible in collateral valuation to manage credit risk in micro finance institutions. As the theory noted that collateral is a risk reduction tool like many other tools and it mitigates risk by reducing credit exposure. Since it is such a tool to manage credit risk the valuation of the collateral provided by the credit applicant is an essential element in the credit approval process and thus has an impact on the overall assessment of the credit risk involved in a possible exposure. Therefore micro finance institutions are expected to determine the value of collateral carefully before granting loan to their clients. To this specific issue the mean response is less than 3.00 and the standard deviation is more than 1.00(see Q13 in Table5). This data reveals that on average the respondents are disagreed that all collaterals are appropriately valued.

The main reason for this poor valuation of collateral is mainly due to lack of full information about that collateral as the data from the interview indicates.

**Table6: Responsibility of Credit Risk Management Committee (CRMC)**

Questions	N	Mean	Std.Deviation
Q14--the CRMC of your institutions Monitor credit risk on a institutions-wide basis and ensure compliance with limits approved by the Board	55	2.73	1.062
Q15-The committee actively participate and decide delegation of credit approving powers, prudential limits on large credit exposures, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance,etc.	55	3.09	1.281

Sources: Questionnaires result

Note :N. number of respondents

As we have discussed in the literature review board is the responsible body in designing appropriate rule and regulations for effective credit risk management. However having these rules and regulations is not a guarantee for credit risk management.

Therefore thus rules and regulations should compliance with institution credit risk management practice and the institutions also should implement and use in practice effectively these rules and regulations.

This task is performed by the credit risk management committee. Concerning this issues the survey indicates that mean response shows that less than 3.00 and the standard deviation is more than 1.00 (see Q14 in Table6). This indicates that on average the respondents are disagreed to this specific question. Therefore we can conclude that the credit risk management committee is not effective in ensuring the compliance between institutions credit risk management practice and board rules and regulations in relation to credit risk management.

The literature also noted that the committee should also actively participate in implementation of the credit risk policy, in monitor credit risk and in deciding delegation of credit approving powers.

This in turn result good credit risk management in the institutions. In connection with this the survey result show that the mean response is 3.09 (i.e close to 3.00) and the standard deviation is more than 1.00 (see Q15 in Table6) which indicates the respondents perception were far away to one another. This reveals that the respondents were demonstrated neutrally to this specific question.

**Table7: Responsibility of Credit Risk Management Department (CRMD).**

Questions	N	Mean	Std.Deviation
Q16-The Department undertake efficient portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.	58	2.43	1.156
Q17--Establish systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning. The department would work out remedial measure when deficiencies/problems are identified.	55	3.16	1.183

Sources: Questionnaires result

Note .N:number of respondents

The theory noted that to test the resilience of the loan portfolio CRMD undertake efficient portfolio evaluation and conduct comprehensive studies on loan repayment. Therefore having well organized credit risk management department with qualified employees under it will result good repayment rate or repayment of loan. This is because the department is responsible in establishing systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning.

The department also would work out remedial measure when deficiencies/problems are identified.

Therefore having well organized credit risk management means the institutions are effective in doing all these functions in relation with credit risk management.

In relation to this specific question the mean response is less than 3.00 and the standard deviation is more than 1.00(see Q16 in Table7) which indicates that the respondents on average give their witness by saying the department is not effective in undertaking efficient portfolio evaluations and in conducting comprehensive studies on the environment to test the resilience of the loan portfolio.

On the other hand regarding the departments efficiency in establishing systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning the survey mean response is around 3.00 and the standard deviation is around 1.00 (see Q17 in table7). This data reveals that the respondents were demonstrated neutrally to this specific question ( i.e Q17)

**Table8: Assessment of Risk Profile of the Customer/Transaction.**

Questions	N	Mean	Std.De viation
Q18-The purpose of credit and source of repayment is critically reviewed.	58	4.09	.708
Q19-The track record / repayment history of borrower is identified before loan is given.	58	3.03	1.451
Q20-Approval from appropriate authority should be one criterion to give loan.	57	3.68	1.325
Q21-Before granting loans your institutions undertake efficient and effective specific analysis regarding the client's characters, capacity, collateral capital and conditions	58	4.10	.810

Sources: Questionnaires result

Note .N: number of respondents

As the theory noted sometimes those clients who lack awareness about credit risk take loans which is not planned and used for the intended purpose, which result to capital wastage of the institution and incur unnecessary collection cost and credit risk. Therefore in order to minimize collection cost and to manage credit risk the institutions should be in a position to critically review the purpose of loan and the source of repayment of loan amount.

When we asked the practice of sample institutions in critically reviewing the purpose and source of repayment of the loan by the customers (clients) the survey result shows that mean response of 4.09 and standard deviation of 0.708 which is less than 1.00(see Q18 in Table8). This data indicates that on average the majority of the respondents agreed that the purpose of credit and source of repayment is critically reviewed by the institutions before loan is granted.

On the other hand MFIs should have experience of identifying the credit history of the clients before going to provide loan to that customer. To do so institutions should devise procedural guidelines and standards for maintenance of credit files.

The credit files not only include all correspondence with the borrower but should also contain sufficient information necessary to assess repayment history of the borrower and its repayment performance. Concerning this specific question the mean response indicates that more than 3.00 and the standard deviation is also more than 1.00(see Q19 in Table8) which indicates that the perception of respondents were far away one another. This data reveals that the majority of the respondents demonstrated neutrally to this question.

The other question in relation to assessment of risk profile of the customer is about the requirement of approval from required authority to grant credit (i.e Q20). In this regard the mean response is more than 3.00 i.e 3.68 and the standard deviation is more than 1.00 i.e 1.325 (see Q20 in Table8) which indicates that the respondents perception were positive to this issue or on average respondents were agreed that approval from appropriate authority should be one criterion to give loan. From this one can learn that it is better to consider approval as one of the criteria by micro finance institutions to grant loan.

In addition to the above three strategy of analyzing risk profile of the clients the other main activities that should be performed by micro finance institutions before granting loan to their client is that undertaking of efficient and effective specific analysis regarding the client's characters, capacity, collateral capital and conditions. In connection with this the mean response of the survey is 4.10 and the standard deviation is 0.810 (see Q21 in Table8).

This data reveals that on average the majority of respondents involved in the survey agreed that the institutions are effective in making efficient and effective specific analysis regarding the client's characters, capacity, collateral capital and conditions before granting loan to clients.

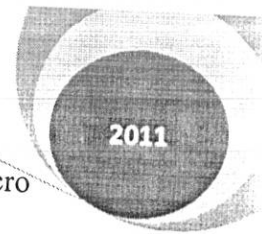
**Table9: Credit Risk Monitoring & Control**

Questions	N	Mean	Std. Deviation
Q22-Efficient and effective assessment procedures and analysis techniques are implemented for individual loans & overall portfolio.	58	3.57	1.028
Q23-There is periodic examination of collaterals and loan covenants.	58	2.41	1.243

Sources: Questionnaires result

Note .N: number of respondents

After the loan is approved and draw down allowed, the loan should be continuously watched over. These follow up include keeping track of borrowers compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.



Finally doing so will lead low probability of occurrence of credit risk in micro finance institutions. To do so the institutions should have a pre designed procedures and analysis techniques that are implemented to monitor and control credit risk. In this regard the mean response from the survey result indicates that more than 3.00 and the standard deviation is also more than 1.00 (see Q22 in Table9). This shows us the perception of respondents is far away one another. Therefore from this we can observe that even though the mean response is more than 3.00 techniques implemented to monitor credit risk is not as such strong enough.

The other question under credit monitoring and control in the above table is that about periodic examination of collaterals for loan covenants (i.e Q23). Regarding this as theory noted that MFI having strong follow up (particularly periodic examination of collateral) system can control credit risk to a large extent. The institutions should have the practice of examining collateral in specified time frame (that can be quarterly, semi-annually or annually).

In connection with this the empirical evidence from survey revealed that the mean response was less than 3.00 and the standard deviation is more than 1.00(see Q23 in Table9). This data reveals that on average the majority of respondents are disagreed to this specific question. That is they believed that the institutions are not as such effective in periodic examination of collateral.

**Table10: Credit Risk Analysis**

Questions	N	Mean	Std.Deviation
Q24-The institution's executive management regularly reviews the organization's performance in managing its business risks	58	3.74	1.052
Q25-Your institution encourages training programs in the area of credit risk management	58	2.36	1.135
Q26-This institution emphasizes the recruitment of highly qualified people in risk management	56	2.43	1.186

Sources: Questionnaires result

Note : N. number of respondents

The literature noted that executive management is the responsible body that regularly reviews the performance of micro finance institutions in credit risk management. However, if the institutions are fail to do so the probability of occurrence of credit risk is high.

Concerning this specific question the mean response is more than 3.00 and at the same time the standared deviation is more than 1.00(see Q24 in Table10) which indicates that the perception of respondents were far away one another.

This reveals that on average respondents are inclined to agree that institution's executive management regularly reviews the organization's performance in managing its business risks particularly credit risk.

On the other hand to have an effective risk management micro finance institutions should ensure that there should be common understanding across the institutions about credit risk management concept.

To create this common understanding on the issue of effective credit risk management the institutions should encourage training program regularly in credit risk management.

Therefore all the staffs of the institutions can have clear information about credit risk management. Having this theoretical fact in connection with this the mean response is less than 3.00 and the standard deviation is more than 1.00(see Q25 in Table 10). This indicates that on average the majority of the respondents were disagreed to this specific question. As a result one can conclude that the institutions are not effective in encouraging training programs in the area of credit risk management

The literature also noted that qualified human resource is also an input to have an effective credit risk management and credit analysis in micro finance institutions. Therefore micro finance institutions should focus on recruitments of highly qualified people in risk management as their integral part of activities. In this regard the researcher asked does the institution focus on recruitments of highly qualified people in risk management the mean response become less than 3.00 and the standard deviation become more than 1.00 (see Q26 in Table 10). From this data one can understand that the majority of the respondents give their witness by disagreeing to this specific question. That is they believed that the institutions does not give emphasizes to the recruitment of highly qualified people in risk management. Finally this lead to poor credit risk management in the institutions.

### **4.1.3 Analysis of Secondary Data**

#### **4.1.3.1 Managing Credit Risk Using Financial Ratios**

MFIs try to have an objectives view of their credit risk and want to measure the extent of credit risk, which is the risk on their portfolio. There are various indicators, which help in measuring the credit risk profile of an MFI. Of these indicators portfolio at risk or commonly known as PAR is considered to be the most effective and is now very common indicator across MFIs. Apart from PAR, Repayment rate is other ratio, which also provides information about the portfolio quality of an MFI.

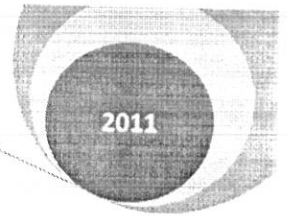
The following table shows the portfolio at risk ratio and repayment rate ratio which are indicator of credit risk management of five micro finance institutions in the study for three consecutive years.

Ratios	GMF			ADCSI			SFPI			AVFS			BGMF		
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010
PAR	18%	20%	15%	2.8%	3.23%	2.51%	3%	2.9%	2.9%	9.2%	8%	8.3%	3.96%	2.81%	1.84%
RR	98%	98%	98%	97.1 %	97%	97.3%	95%	95%	96%	95%	96.3%	95.4%	96%	97.72%	98.89%

Source-Respective Institutions Recording (Detail data is attached to appendix)

From the table one can understand that the institutions are in a good position in loan repayment collection i.e. almost all the institutions repayment rate ratios is above their respective standard. The repayment rate standard for the institutions is almost the same for all i.e. 95% and above. Therefore as we see from the table almost all institutions repayment rate is above the institutions standard. However having repayment rate above the required standards is not the only good indicator of effective credit risk management. This is because repayment rate ratio is not able to capture the future risk i.e. repayment rate only provide information of current loss and indicate the past performance.

On the other hand the portfolio at risk ratios of some institutions is below their respective standard and the industry standards. For example when we consider the case of Gash micro finance institution and Africa village financial service institutions the normal standard of PAR is 10% and 5% for the two institutions respectively. However, the institutions PAR ratio of these two institutions for the year 2008-2010 is above their respective standard (i.e.18%, 20% and 15% for GMF and 9.2%, 8% and 8.3% for AVFS) respectively. At the same time their PAR is above the industry average (i.e5%). From the data we can say that these two institutions are not as such effective in credit risk management since portfolio at risk ratio is the best indicator for risk. PAR is the best indicator of risk, because PAR is a forward looking ratio and provides an estimate of the total loss that an MFI is likely to make should the risky clients default. On the other hand the other institutions like ADCSI, SFPI and BGMF have PAR ratio of below their respective standard and industry average. This indicates that these institutions are relatively in a good position in managing credit risk. However it does not mean they are highly effective as required in credit risk management.



## **4.2 Presentation and Analysis of Qualitative Data**

In this section qualitative data which are obtained from the respective micro finance institutions in the form of interview were presented and analyzed.

### **4.2.1 Major Problems Micro Finances Face in Credit Risk Management**

According to the response of interviewee the following are major problem that most micro finance faces i.e major cause of credit risk. The institutions believed that these problems have negative impact on credit risk management.

- ◆ The users are not willing to pay borrowed amount with interest at the maturity period.
- ◆ The institution also faces problem of lack skilled human power that facilitate the day-to-day activities of the institutions.
- ◆ Borrowers lack awareness and takes loans which is not planned and used for the intended purpose, which result to capital wastage of the institution and incur unnecessary collection cost.
- ◆ On the other hand some clients need less interest rate and monthly repayment.
- ◆ Although the institutions expand guarantee system for clients some borrower need larger loan but unable to get proper guarantee as to the polices of the institutions.

Generally from the response of the interviewee we can understand that the major problem of microfinance institutions in relation to credit risk is emanated from the clients or borrowers.



#### **4.2.2 Measures Taken to Uncollectable Loan Amounts**

According to the interviewee when borrower fails to repay the loan amount periodically, the following measures are taken sequentially by the institutions.

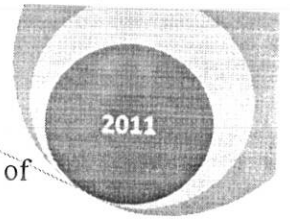
- ◆ The credit committee conducts a survey about why users fail to repay the loan on time.
- ◆ The committee made interview with the borrowers about the reason they fail to repay the loan on time and give notice for the borrower (grace period).
- ◆ If the borrower is still not voluntary to repay the loan after receiving the notice he or she is obliged of not repaying the loan.
- ◆ If the borrower is again not voluntary to repay the loan his or her collateral is used to recover the loan.
- ◆ If the institution is unable to recover the loan amount from borrower using all the above procedures it will collect the necessary document and evidence to file a case against the borrower and takes legal action.



#### **4.2.3 Types of Collateral Needed by the Institutions**

According to the interviewee of the respective micro finance institutions the following are types of collateral or guarantee required by the institutions from the borrower to give loan. The institutions considers these collateral or guarantees as a means of credit risk management strategy.

- ◆ Group guarantee
- ◆ Salary of permant employees of different organizations
- ◆ Collateral (house or vehicles)
- ◆ Client of the institutions based on their saving and business enterprise
- ◆ Joint individual and machineries guaranties
- ◆ Joint checks and viechles
- ◆ Jewelry like gold silvers and the like
- ◆ Not receivables
- ◆ Television and movable properties particularly for womens
- ◆ Amount paid for equab
- ◆ Leased land
- ◆ Edires, cooperatives, governmental and nongovernmental organizations and public enterprises.



According to interviewee even though the institutions require different types of collateral or guarantees from borrowers to give loan, some borrower are not able to provide the required collateral for the amount they need to borrow. The institutions also face great problem in valuation of some collaterals and identification of the quality of collateral provided by the clients.

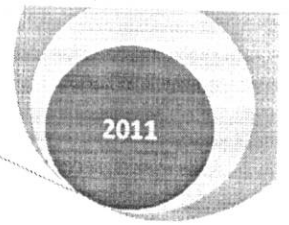
## Chapter Five

### Summary of Findings, Conclusions and Recommendations

#### 5.1 Summary of Findings

From the above analysis the following are the main findings of the study:

- ◆ The performance of institutions is weak in efficient and effective internal credit quality review.
- ◆ There is problem of common understanding of credit risk management across the institutions.
- ◆ Staffs do not possess sound and expertise knowledge as required.
- ◆ Board of the intuitions implement sound principle to identify measure, monitor and control credit risk
- ◆ The institutions board is effective in setting appropriate plan and procedures to manage credit risk.
- ◆ Institutions are effective in client segmentation to grant credit to clients.
- ◆ The institutions are highly effective in risk identification.
- ◆ Institutions are well qualified in designing detailed and formalized credit evaluation process.
- ◆ Institutions have well designed Credit administration and loan documentation procedures.
- ◆ There is no as such satisfactory compliance between the institutions credit risk management practice and board rule and regulations regarding credit risk management.



- ◆ Credit risk management committee is not actively participating as required to manage credit risk.
- ◆ Institutions are not as such effective in efficient portfolio evaluation and in conducting comprehensive studies on loan repayment by their credit risk department.
- ◆ There is strong enough credit assessment of borrowers industry and macro economic factors
- ◆ Institutions are highly effective in determining and reviewing the purpose and source of repayment.
- ◆ Institutions are well performed in identifying repayment history of borrowers (clients).
- ◆ Institutions are not experienced in periodic examination of collateral.
- ◆ The institutions have drawback in encourage training program in credit risk management
- ◆ Institutions are not effective in recruitments of highly qualified people in risk management
- ◆ The major problem of microfinance institutions in relation to credit risk is largely emanated from the sides of clients or borrowers.
- ◆ Institutions face great problem in valuation of some collaterals and identification of the quality of collateral provided by the clients.

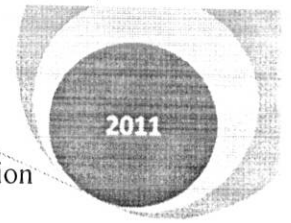


## 5.2 conclusions

Credit risk management is the way that micro finance institutions seeks to minimize the exposure of their losses emanating from loan delinquencies and defaults. Major credit risk management methods are loss control, loss financing and internal risk reduction. The overall objective is maximization of business value to shareholders by minimizing the cost of risk.

Micro finance played a key role in process of transition from central planned to market economy. The enormous demand for credits needed to privatization has been satisfied under the conditions of insufficiently prepared legislative and under the lack of needed knowledge and experiences with credit risk management in the institutions and lack of knowledge in assessing of creditworthiness of borrowers. The situation was also complicated due to poor collateral valuation, poor training program by micro finance institutions to their employees about credit risk management, weak understanding of credit risk across the institutions and poor periodical examination of collateral by the institutions.

When we come to methods of credit risk mitigation, the possibilities of micro finance institutions in Ethiopia are a little limited. The insufficiently developed capital market in the country (i.e Ethiopia) does not allow using credit derivatives and due to the absence of secondary market the institutions cannot sale loans. Despite of this, micro finance institutions can use group guarantees and collaterals (most often house and other movable properties like viechles, note receivables and deposits as well). But the current trend is to provide more and more unsecured loans.

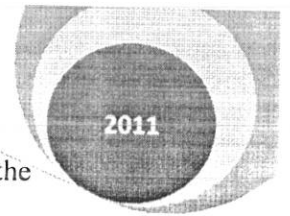


On the other hand the institutions are effective in designed credit administration and loan documentation procedures, in setting appropriate plan and procedures to manage credit risk, in designing detailed and formalized credit evaluation process, and in implementing sound principle to identify measure, monitor and control credit risk.



### 5.3 Recommendations

- ◆ It is better for the institutions to focus on recruitment of qualified employees since those people are with better understanding about credit risk.
- ◆ The institutions should work more in creating awareness and common understanding across the institutions about the issue of credit risk.
- ◆ The institutions also expected to give attention to encouraging of training program about credit risk since training are the tools that can provide knowledge and further understanding to employees of the institutions about credit risk.
- ◆ The institutions should develop the practice of examining collaterals in specified time frame since these collaterals may be deteriorating due to different reasons.
- ◆ For some micro finance institutions like Bussa Gonofa micro finance institutions there is no credit risk management committee, therefore it is better for the institution to have this committee since the committee is useful in implementation of the credit risk policy, in monitor credit risk and in deciding delegation of credit approving powers that in turn result good credit risk management in the institutions. Even those micro finance institutions that have the committee do not show good performance so the management of respective institutions should look again the practice of the committee and take corrective actions.
- ◆ The institutions should work more on reviewing practice credit quality since it contributes efficiency in credit risk management process.



- ◆ The institutions should have a committee that actively participate in the valuation collaterals and assessment of the quality of collaterals.
  
- ◆ The institutions should work more on creating of awareness to their clients about the purpose of loan and the way how to do business using the loan amount.
  
- ◆ It is better for the institutions to do supervision of their clients to minimize the probability of occurrence of credit risk

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# Appendices

**ADDIS ABABA UNIVERSITY**  
**COLLEGE OF BUSINESS AND PUBLIC ADMINISTRATION**  
**DEPARTMENT OF ACCOUNTING AND FINANCE**  
**SCHOOL OF GRADUATE STUDY**

This questioner is designed to conduct a research on the topic, *Assessment of Performance of Micro Finance Institutions in Credit Risk Management: The Case of Five Micro Finance in Addis Ababa*. The purpose of the study is for the partial fulfilment of the requirement of MSc degree in accounting and finance. Therefore for successful accomplishment of the study the response of employees of the micro finance institutions will have pivotal role by being used as valuable input for the study. So you are kindly requested to genuinely fill the questioners.

**Thank you in advance for your cooperation!**

**Instructions:-**

- ◆ No need of writing your name.
- ◆ Put “√” mark as per the question required in the box.

**Part One: Respondents Profile**

1. Sex . Male . Female
2. Age (years) . Below25 .25-35 . 35-50 . above 50
3. Educational Level . 10/12 Grade complete . Certificate .Diploma . Degree . Above Degree
4. Position-----

**Part Two:-Close Ended Questions Related to Research Topic**  
**1-General Credit Risk Management System**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
<b>Q1-</b> There is clear description of the methodology for assessing credit risk;					
<b>Q2-</b> There is efficient and effective internal credit quality reviews;					
<b>Q3-</b> There is a common understanding of credit risk management across the institutions					

**2-Board Oversight in Credit Risk Management**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
<b>Q4-</b> Board ensure that MFI's overall credit risk exposure is maintained at prudent levels and consistent with the available capital					
<b>Q5-</b> Board Ensure that top management as well as individuals responsible for credit risk management possess sound expertise and knowledge to accomplish the risk management function					
<b>Q6-</b> Board Ensure that the MFI implements sound fundamental principles that facilitate the identification, measurement, monitoring and control of credit risk.					
<b>Q7-</b> Board Ensure that appropriate plans and procedures for credit risk management are in place.					

### 3-The Institution's Credit Risk Strategy

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
Q8-The institution's plan to grant credit based on various client segments and products, economic sectors, geographical location, currency and maturity					
Q9-The institution carries out a comprehensive and systematic identification of its risks relating to each of its declared aims and objectives					

### 4-Responsibility of Senior Management of the Institutions in Policy Designing of Credit Risk Management

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
Q10-There is Detailed and formalized credit evaluation/appraisal process that can be easily understandable by borrower.					
Q11-Risk acceptance criteria is clearly stated in the institutions loan policy.					
Q12-there is clear and easily understandable Credit origination and credit administration and loan documentation procedures.					
Q13-Establishing procedures to ensure that all collateral held by the credit institution in addition to available for sale financial assets, are appropriately valued by personnel independent of the credit origination function;					

**5-Responsibility of Credit Risk Management Committee (CRMC)**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
<b>Q14</b> --the CRMC of your institutions Monitor credit risk on a institutions-wide basis and ensure compliance with limits approved by the Board					
<b>Q15</b> --The committee actively participate and decide delegation of credit approving powers, prudential limits on large credit exposures, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance,etc.					

**6-Responsibility of Credit Risk Management Department (CRMD).**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
<b>Q16</b> --Establish systems and procedures relating to risk identification, Management Information System, monitoring of loan / investment portfolio quality and early warning. The department would work out remedial measure when deficiencies/problems are identified.					
<b>Q17</b> --The Department undertake efficient portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.					

Strongly

**7-Assessment of Risk Profile of the Customer/Transaction.**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
Q18-The purpose of credit and source of repayment is critically reviewed.					
Q19-The track record / repayment history of borrower is identified before loan is given.					
Q20-Approval from appropriate authority should be one criterion to give loan.					

**8-Credit Risk Monitoring & Control**

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
Q21-Efficient and effective assessment procedures and analysis techniques are implemented for individual loans & overall portfolio.					
Q22-There is periodic examination of collaterals and loan covenants.					

### 9-Credit Risk Analysis

Questions	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
<b>Q23-</b> Before granting loans your institutions undertake efficient and effective specific analysis regarding the client's characters, capacity, collateral capital and conditions					
<b>Q24-</b> The institution's executive management regularly reviews the organization's performance in managing its business risks					
<b>Q25-</b> Your institution's policy encourages training programs in the area of credit risk management					
<b>Q26-</b> This institution emphasizes the recruitment of highly qualified people in risk management					

Part Three: Interview Questions

1-How does your institution measure credit risk?

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2-What are the causes of non performance loan in your institutions?

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3-What are the existing strategies implemented in your institution to manage credit risk?

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4-What types of collaterals are required from the customers to gain loan from your institution?

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5-What measures are taken for uncollectible loan amount?

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**SOURCE: REVIEW OF LITERATURE**

**BY: ALEBACHEW GOSHIM**

**Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
sex	58	1	2	1.36	.485
age	58	1	3	2.26	.515
education	58	2	5	3.62	.557
macr	58	1	5	3.90	.912
CQR	58	1	5	2.88	1.215
understanding	58	1	5	2.69	1.158
responsibility	58	1	5	3.33	1.176
consistency	58	1	4	3.05	1.050
knowlagde	58	1	5	2.64	1.119
principle	58	1	5	3.22	1.060
PP	58	1	5	3.45	1.157
CGC	58	2	5	3.93	.876
CSIR	58	1	5	3.71	1.076
CEP	58	2	5	4.03	.973
CAA	57	1	5	3.95	1.042
RAC	58	1	5	3.91	1.014
CADP	58	2	5	4.03	.674
role	58	2	5	3.74	1.001
CVP	58	1	5	2.76	1.189
compliance	55	1	5	2.73	1.062
policiece	55	1	5	2.98	1.240
participation	55	1	5	3.09	1.281
SP	55	1	5	3.16	1.183
PE	58	1	5	2.43	1.156
CA	58	1	5	3.48	1.096
PSA	58	2	5	4.09	.708
RHB	58	1	5	3.03	1.451
Aproval	57	1	5	3.68	1.325
techniqe	58	2	5	3.57	1.028
examination	58	1	5	2.41	1.243
monitarng	58	1	5	3.86	1.083
analysis	58	2	5	4.10	.810
CFAL	58	2	5	3.71	1.200
CFSL	58	1	5	3.50	1.274
Review	58	1	5	3.74	1.052
fedback	58	1	5	3.53	1.080
training	58	1	4	2.36	1.135
recuriment	58	1	4	2.43	1.186
Valid N (listwise)	54				

CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 BALANCE SHEET  
 30 JUNE 2009

3,240,450

	<u>Notes</u>	<u>Birr</u>	<u>Birr</u>	<u>2000</u> <u>Birr</u>
<b>EMPLOYED</b>				
ASSETS (NET)	2a,4		5,594,309.01	4,837,652.00
TRACTION IN PROGRESS			29,761.50	-
FIXIBLE ASSET	3e,6		35,161.67	79,803.00
<b>CURRENT ASSETS</b>				
Office and stationery supplies	3d	365,597.24		406,142.00
Accounts receivable	7	317,654,387.29		242,096,121.00
Investment receivable	8	1,857,817.38		2,949,995.00
Payments and advances	9	4,960,533.64		2,059,625.00
Cash and bank balance	10	<u>54,506,843.18</u>		<u>39,615,473.00</u>
		<u>379,345,178.73</u>		<u>287,127,356.00</u>
<b>CURRENT LIABILITIES</b>				
Accounts savings	11	86,089,024.94		62,758,019.00
Trade creditors	12	6,858,232.97		2,743,533.00
Medium term loan - current maturity	14	<u>1,044,636.00</u>		<u>6,267,816.00</u>
		<u>93,991,893.91</u>		<u>71,769,368.00</u>
<b>Current Assets</b>			<u>285,353,284.82</u>	<u>215,357,988.00</u>
			291,012,517.00	220,275,443.00
Medium term loan	14		(6,527,595.50)	(6,545,844.00)
Long term loan - DBE	13		<u>(8,703,000.00)</u>	<u>(8,703,000.00)</u>
Fixed asset			<u>275,781,921.50</u>	<u>205,026,599.00</u>
<b>PRESENTED BY</b>				
Capital authorized and paid up 10,170 shares				
of Birr 100 per value each			1,017,000.00	1,017,000.00
Administration capital	15		232,192,950.00	173,192,950.00
Retained capital	16		4,813,293.00	4,813,293.00
Reserve	17		9,439,669.62	6,500,839.00
Non-distributable profit	18		<u>28,319,008.88</u>	<u>19,502,517.00</u>
			<u>275,781,921.50</u>	<u>205,026,599.00</u>



**CREDIT AND SAVING INSTITUTION SHARE COMPANY**  
**INCOME STATEMENT**  
**FOR THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009**

DESCRIPTION	Notes	Birr	Birr	7/7/2008 Birr
Interest income		21,480,222.52		18,402,845.00
Service income		2,546,523.84		2,575,601.00
Commission		<u>74,061.28</u>		<u>3,301.00</u>
			24,100,807.64	<u>20,981,747.00</u>
<b>FINANCIAL EXPENSE</b>				
Interest expenses on client saving deposits		3,094,667.00		2,269,143.00
Interest expenses on bank loan		1,363,661.57		1,359,808.00
Provision for non performing loan		<u>2,640,061.00</u>		<u>284,584.00</u>
			(7,098,389.57)	<u>(3,913,535.00)</u>
Net Interest Income After Provision for non Performing Loans			17,002,418.07	17,068,212.00
Other Income	19		<u>5,629,475.18</u>	<u>3,118,775.00</u>
			22,631,893.25	20,186,987.00
<b>GENERAL AND ADMINISTRATION EXPENSES</b>				
Salaries and related benefits		7,064,545.21 ✓		6,151,042.00
Annual Leave		22,072.76 ✓		-
Board fee		16,100.00		16,530.00
Education and training expenses		144,089.96		64,227.00
Telephone		135,043.16 ✓		129,640.00
Electricity and water		12,693.42 ✓		32,838.00
Repair and maintenance		174,403.05 ✓		64,093.00
Office supplies and stationary		644,448.35		433,835.00
Fuel and lubricants		118,947.78		109,808.00
Depreciation and amortization		771,852.29		495,094.00
Periodicals and advertisement		116,643.76		118,842.00
Medical		102,063.66 ✓		68,496.00
Uniform		12,814.80 ✓		7,199.00
Entertainment		54,737.55		37,975.00
Bank charge		15,506.66		10,714.00
Registration and legal fee		511,006.51		284,536.00
Professional fee		235,937.50		113,152.00
Audit fee		27,600.00		46,000.00
Insurance		266,704.89		337,994.00
Miscellaneous		315,960.92		56,052.00
Office rent		145,842.58		70,324.00
Traveling and Perdiem		28,636.75		5,390.00
Cleaning and sanitation		<u>1,644.94</u>		<u>553.00</u>
			(10,937,296.50)	<u>(8,654,334.00)</u>
<b>NET INCOME FOR THE YEAR</b>			11,694,596.75	11,532,653.00
<b>PRIOR YEAR ADJUSTMENT</b>			60,725.75	-
			<u>11,755,322.50</u>	<u>11,532,653.00</u>
<b>APPROPRIATION</b>				
Legal serve (25%)			2,938,830.62	2,883,163.00
Non-Distributable profit			<u>8,816,491.88</u>	<u>8,649,490.00</u>
			11,755,322.50	11,532,653.00



CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 CASH FLOW STATEMENT  
 FOR THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

	<u>Notes</u>	<u>Birr</u>	<u>Birr</u>	<u>7/7/2008</u> <u>Birr</u>
<b>Flows from Operating Activities</b>				
Income for the year			11,649,596.75	11,532,653.00
Adjustment for:-				
Provision for bad debts		-		284,584.00
Paid interest expense on long-term loan - FBE		-		-
Depreciation and amortization		771,852.29		495,094.00
Year adjustment		60,725.75		-
			<u>832,578.04</u>	<u>779,678.00</u>
<b>Operating Profit Before Working Capital Changes</b>			<b>12,482,174.79</b>	<b>12,312,331.00</b>
Increase/Decrease in inventory		40,544.76		94,920.00
Increase in loans receivable		(75,558,266.29)		(71,174,308.00)
Increase/ Increase in interest receivable		1,092,177.62		(2,583,830.00)
Increase in prepayments and advance		(2,900,908.64)		(821,424.00)
Increase/ Increase in clients savings		23,331,005.94		13,110,823.00
Increase in sundry creditors		4,114,699.97		1,737,781.00
			<u>(49,880,746.64)</u>	<u>(59,636,038.00)</u>
			<b>(37,398,571.85)</b>	<b>(47,323,707.00)</b>
<b>Flows from Investing Activities</b>				
Construction in Progress		(29,761.50)		-
Acquisition of Fixed assets and intangible assets		(1,483,868.04)		(1,450,107.00)
			<u>(1,513,629.54)</u>	<u>(1,450,107.00)</u>
<b>Flows from Financing Activities</b>				
Capital Contribution		-		500,000.00
Administration capital contribution received		59,000,600.00		34,504,388.00
Equity capital obtained		-		272,199.00
Proceeds from long term loan		-		-
Principal loan payment		(5,241,428.50)		(5,661,239.00)
			<u>53,758,571.50</u>	<u>29,615,348.00</u>
Increase) increase in cash and cash equivalents			<b>14,846,370.11</b>	<b>(19,158,466.00)</b>
Cash and cash equivalents at beginning of the year			<u>39,615,473.07</u>	<u>58,773,939.00</u>
Cash and cash equivalents at the end of the year			<u>54,461,843.18</u>	<u>39,615,473.00</u>



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 ES TO THE ACCOUNT  
 THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

FIXED ASSETS

COSTS	Balance	Additions	Balance
	7/7/2008		30/06/09
	<u>Birr</u>	<u>Birr</u>	<u>Birr</u>
Building	2,935,958.00	678,066.56	3,614,024.56
Motor vehicles	1,684,417.00	750,000.00	2,434,417.00
Office equipment, Computer and Accessories	1,592,851.00	21,800.00	1,614,651.00
Office furniture and fixture	617,321.19	25,367.48	642,688.67
Other assets	25,151.15	8,634.00	33,785.15
	<u>6,855,698.34</u>	<u>1,483,868.04</u>	<u>8,339,566.38</u>
<b>DEPRECIATION</b>			
Building	265,521.60	166,982.25	432,503.85
Motor vehicles	806,221.36	264,953.36	1,071,174.72
Office equipment, Computer and Accessories	693,620.27	239,080.79	932,701.06
Office furniture and fixture	229,838.09	55,514.66	285,352.75
Other assets	22,845.09	679.90	23,524.99
	<u>2,018,046.41</u>	<u>727,210.96</u>	<u>2,745,257.37</u>
<b>BOOK VALUE</b>	<u>4,837,651.93</u>		<u>5,594,309.01</u>

INTANGIBLE ASSETS

This represents cost of TMS soft ware net of amortization expense for the year as follows:

	<u>Birr</u>	<u>Birr</u>
Cost: BBF		295,300.00
Current year additions		-
		<u>295,300.00</u>
Less: Amortization BBF	(215,497.00)	
Current year addition	<u>(44,641.33)</u>	
		<u>(260,138.33)</u>
		<u>35,161.67</u>



DIS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 TES TO THE ACCOUNT  
 R THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

LOANS RECEIVABLE

These represent loans disbursed to different Addis Ababa City Kefle Ketemas. The loan balance are expected to be recovered fully within three years. The breakdowns of the balances by Kefle Ketema are as follows:-

<u>Kifle Ketema</u>	<u>Birr</u>	<u>7/7/2008</u>
		<u>Birr</u>
Addis Ketema	28,294,937.09	23,306,479.00
Akaki	20,894,139.13	16,998,906.00
Arada	26,923,350.44	22,673,866.00
Bole	24,226,463.98	19,587,841.00
Gulele	24,191,470.44	20,279,497.00
Kirkos	19,311,315.68	14,403,409.00
Kolfe	24,920,483.02	18,929,306.00
Head Office	7,837,137.94	9,103,851.00
Leideta	12,304,429.97	10,773,361.00
Nifas Silk	22,383,473.72	19,210,344.00
Yeka	54,869,172.05	47,562,067.00
Micro Banks - Arada, Kolfe, Yeka and Mesalemiya	55,041,445.83	21,101,066.00
	<u>321,197,819.29</u>	<u>243,929,993.00</u>
Less:- Provision for doubtful loans	<u>(3,543,432.00)</u>	<u>(1,833,871.00)</u>
	<u>317,654,387.29</u>	<u>242,096,122.00</u>

Loans have been shown net of provision provided for non-performing loans.

Interest on loan is accrued on the principal amount of loan outstanding

The adequacy of the allowance for non-performing loan is evaluated quarterly by management.

Management provided provisions for non-performing loan every quarter in order to maintain the reserve for non performing loan at adequate levels. The adequacy of the provision for non performing loan is determined by applying defined percentage to the outstanding loan balance in various aging categories, as follows:

<u>Loan status</u>	<u>Percentage for Allowance</u>
1-90 days overdue	0
91-180 days overdue	25
181-365 days overdue	50
>365 days over due	100



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 ES TO THE ACCOUNT  
THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

INTEREST RECEIVABLE

This represents interest income earned but not collected on loan disbursed to the clients, less the provision for interest income of non performing loan estimated by the Company's management as follows:

	<u>Birr</u>	7/7/2008 <u>Birr</u>
Interest receivable	2,543,029.29	3,635,207.00
Less: Provision for doubtful interest	(685,211.91)	(685,212.00)
	<u>1,857,817.38</u>	<u>2,949,995.00</u>

REPAYMENTS AND ADVANCES

	<u>Birr</u>	7/7/2008 <u>Birr</u>
Repaid others	3,250,979.77	-
Repaid office rent	137,833.45	62,383.00
Staff debtors	1,232,887.72	1,566,914.00
Staff long term loan	155,756.81	210,775.00
Repaid insurance	4,813.48	41,291.00
Receivable from EU	178,262.41	178,262.00
Unauthorized cash withdrawal	285,285.00	285,285.00
	<u>5,245,818.64</u>	<u>2,344,910.00</u>
Less:- Provision for doubtful loans	(285,285.00)	(285,285.00)
	<u>4,960,533.64</u>	<u>2,059,625.00</u>



DIS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 RES TO THE ACCOUNT  
 THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

CASH AND BANK BALANCES

	<u>Birr</u>	7/7/2008 <u>Birr</u>
Cash at bank	53,693,143.18	39,613,873.00
Cash on hand	22,200.00	1,600.00
Petty Cash	54,000.00	-
Saving withdrawal fund	737,500.00	-
	<u>54,506,843.18</u>	<u>39,615,473.00</u>

CLIENT'S SAVINGS

Client savings comprise interest bearing compulsory, group, center, security, voluntary and non-borrowers savings. Group center and voluntary savings are savings which clients save at their own interest. Compulsory and security savings are group savings maintained as guarantee of the loan whereby the borrowers undertake to be liable jointly and severally for defaulted loan of any one of group members as per by law of the institution. The detail of the balance is listed here below:-

	<u>Birr</u>	7/7/2008 <u>Birr</u>
Time Deposit - ABATTOIRS	10,000,000.00	-
Compulsory	9,396,574.69	8,092,502.00
Group	1,552,516.63	1,082,689.00
Center	668,794.86	645,744.00
Security	28,169,063.13	25,179,929.00
Voluntary	9,134,201.42	5,118,787.00
Non borrowers savings	23,441,340.98	19,886,291.00
Insurance savings	1,275,461.50	1,112,589.00
Insurance premium	2,451,071.73	1,639,488.00
	<u>86,089,024.94</u>	<u>62,758,019.00</u>

2. SUNDRY CREDITORS

	<u>Birr</u>	7/7/2008 <u>Birr</u>
ETV- Payable	399,521.35	-
Interest payable	577,655.49	450,557.00
Credit Association and Social Contribution	34,290.54	28,206.00
Income tax	62,902.41	52,287.00
Pension Contribution payable	45,336.70	39,581.00
Audit fee	27,600.00	46,000.00
Withholding tax payable	636.29	11,737.00
Accruals	7,409.53	4,252.00
Loan payable to customers	770,902.28	770,902.00
Others	1,373,437.35	1,083,195.00
Third party deposit	173,777.79	256,816.00
Payroll fund	356,049.28	-
Social Security	3,028,722.86	-
	<u>6,858,232.97</u>	<u>2,743,533.00</u>



CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 TO THE ACCOUNT  
 THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

LONG TERM LOAN

company obtained long term loaned of Birr 8,703,000 from Development Bank of Ethiopia in the previous years at interest rate of 6% per annum. The loan is repayable in ten equal semi annual installments of Birr 870,300 on January 31 and July 31 of each year starting on July 31, 2012 up to January 31, 2017.

LONG TERM LOAN

company also obtained long term loan of Birr 20,000,000 from Commercial Bank of Ethiopia in the previous years at interest rate of 5.2% per annum. The loan is repayable in equal monthly installments of Birr 522,318 starting from 28 February 2007 up to August 8, 2010.

The break down of the loan balance of Commercial Bank of Ethiopia is shown below:-

	<u>Birr</u>
Outstanding loan balance	7,572,231.50
Current maturity	<u>(1,044,636.00)</u>
Medium term portion	<u>6,527,595.50</u>

CITY ADMINISTRATION CAPITAL

The amount represents budgetary grant obtained from Addis Ababa City Government the details are as follows:-

	<u>Birr</u>	<u>7/7/2008</u> <u>Birr</u>
Balance brought forward at the institution's establishment date	1,661,670.00	1,661,670.00
Cash grant received from Region 14 Finance Bureau:-		
- For purchase of Fixed asset	788,848.00	788,848.00
- For additional loan disbursement	46,048,023.00	46,048,023.00
Collection of Addis Ababa City Government Loans	1,662,156.00	1,662,156.00
Additional fund from Central Treasury	181,517,683.00	122,517,683.00
Loan transferred to capital	365,510.00	365,510.00
Grant received in cash from Women's Affairs Bureau	69,500.00	69,500.00
Others	79,560.00	79,560.00
	<u>232,192,950.00</u>	<u>173,192,950.00</u>



CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 TO THE ACCOUNT  
 THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

TION CAPITAL

Received from:-

ment of Addis Ababa HIV/AIDS premonition and control office  
 y Development Ethiopia Siddhartha Foundation Belgium  
 received from EU  
 received from ANPPCAN Ethiopia  
 Ababa City Women Democratic Association Prior to the  
 ablishment of the Institution  
 rated Family Service Organization  
 s Ababa City Government Social and Labour Affair Bureau  
 International  
 munity development service  
 er H.S.I Children's Home Relief Organization  
 Ethiopia  
 ghters of Charity Urban Development Project  
 ci Corps

	7/7/2008
<u>Birr</u>	<u>Birr</u>
84,375.00	84,375.00
70,000.00	70,000.00
2,000,000.00	2,000,000.00
15,000.00	15,000.00
77,000.00	77,000.00
100,000.00	100,000.00
614,118.00	614,118.00
583,581.00	583,581.00
24,200.00	24,200.00
100,000.00	100,000.00
872,820.00	872,820.00
194,175.00	194,175.00
78,024.00	78,024.00
<u>4,813,293.00</u>	<u>4,813,293.00</u>

AL RESERVE

ce brought forward  
 nt year appropriation

	7/7/2008
<u>Birr</u>	<u>Birr</u>
6,500,839.00	3,617,676.00
2,938,830.62	1,883,163.00
<u>9,439,669.62</u>	<u>5,500,839.00</u>

N DISTRIBUTIONAL PROFIT

ce brought forward  
 nt year appropriation

	7/7/2008
<u>Birr</u>	<u>Birr</u>
19,502,517.00	10,853,027.00
8,816,491.88	8,649,490.00
<u>28,319,008.88</u>	<u>19,502,517.00</u>

HER INCOME

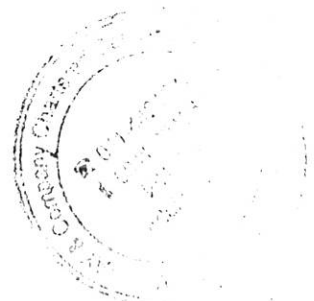
s of pass books  
 est from savings  
 rance income  
 rs  
 ation income  
 lty  
 t income  
 tten back of non performing loan  
 rest income on time deposit

	7/7/2008
<u>Birr</u>	<u>Birr</u>
43,222.07	39,053.00
15,720.89	566,967.00
2,194,348.10	1,178,001.00
418,275.06	190,537.00
-	6,006.00
1,586,011.72	1,138,211.00
93,100.84	-
930,500.00	-
348,296.50	-
<u>5,629,475.18</u>	<u>3,118,775.00</u>



DIS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 BALANCE SHEET  
 AT 30 JUNE 2010

ASSETS EMPLOYED	Notes	Birr	Birr	2009 Birr
FIXED ASSETS (NET)	3a,5		7,090,775.99	5,594,309.01
CONSTRUCTION IN PROGRESS			6,288,018.38	29,761.50
TANGIBLE ASSET	3e,6		1.00	35,161.67
INVESTMENT (Addis Hiberet Bank S.c.)			6,000,000.00	-
<b>CURRENT ASSETS</b>				
Office and stationery supplies	3d	562,284.00		365,597.24
Loans receivable	7	409,867,028.91		317,654,387.29
Interest receivable	9	1,734,227.59		1,857,817.38
Prepayments and advances	10	12,339,369.19		4,960,533.64
Cash and bank balance	11	<u>79,693,899.96</u>		<u>54,506,843.18</u>
		504,196,809.65		<u>379,345,178.73</u>
<b>CURRENT LIABILITIES</b>				
Clients savings	12	127,114,994.35		86,089,024.94
undry creditors	13	18,802,665.00		6,858,232.97
Medium term loan - current maturity-CBE	15	<u>1,504,282.70</u>		<u>1,044,636.00</u>
		147,421,942.05		93,991,893.91
<b>Net Current Assets</b>			<u>356,774,867.60</u>	<u>285,353,284.82</u>
Provision for bad expense	8		376,153,662.97	291,012,517.00
			5,700,575.83	-
Medium term loan-CBE	15		(30,000,000.00)	(6,527,595.50)
Long term loan - DBE	14		<u>(8,703,000.00)</u>	<u>(8,703,000.00)</u>
<b>Net asset</b>			<u>343,151,238.80</u>	<u>275,781,921.50</u>
<b>PRESENTED BY</b>				
Capital authorized and paid up 10,170 shares of Birr 100 per value each			1,017,000.00	1,017,000.00
Reserve Administration capital	16		282,192,950.00	232,192,950.00
Donated capital	17		4,792,294.08	4,813,293.00
Legal reserve	18		13,787,248.68	9,439,669.62
Non-distributable profit	19		<u>41,361,746.05</u>	<u>28,319,008.88</u>
			<u>343,151,238.80</u>	<u>275,781,921.50</u>



S CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 INCOME STATEMENT  
 FOR THE YEAR ENDED 30 JUNE 2010

DESCRIPTION	Notes	Birr	Birr	2009 Birr
Interest income		31,234,428.46		21,480,222.52
Service income		3,183,399.04		2,546,523.84
Commission		<u>1,593,194.53</u>		<u>74,061.28</u>
			36,011,022.03	<u>24,100,807.64</u>
<b>FINANCIAL EXPENSE</b>				
Interest expenses on client saving deposits		4,115,220.21		3,094,667.00
Interest expenses on bank loan		2,062,264.11		1,363,661.57
Provision for non performing loan		<u>4,675,077.03</u>		<u>2,640,061.00</u>
			(10,852,561.35)	<u>(7,098,389.57)</u>
Interest Income After Provision for Non Performing Loans			25,158,460.68	17,002,418.07
Other Income	20		<u>5,640,806.84</u>	<u>5,629,475.18</u>
			30,799,267.52	<u>22,631,893.25</u>
<b>GENERAL AND ADMINISTRATION EXPENSES</b>				
Salaries and related benefits		8,264,320.49		7,064,545.21
Annual Leave		44,692.36		22,072.76
Guard fee		36,800.00		16,100.00
Education and training expenses		148,205.98		144,089.96
Telephone		150,705.50		135,043.16
Electricity and water		67,997.91		12,693.42
Rent and maintenance		148,732.25		174,403.05
Office supplies and stationary		1,214,042.56		644,448.35
Oil and lubricants		218,547.30		118,947.78
Depreciation and amortization		1,009,859.97		771,852.29
Medicals and advertisement		88,422.25		116,643.76
Medical		187,233.40		102,063.66
Uniform		20,799.00		12,814.80
Entertainment		121,533.62		54,737.55
Bank charge		34,805.79		15,506.66
Registration and legal fee		421,414.62		511,006.51
Professional fee		310,402.69		233,937.50
Printing fee		27,600.00		27,600.00
Insurance		385,842.26		266,704.89
Miscellaneous		279,955.45		315,960.92
Office rent		140,150.68		145,842.58
Traveling and Perdiem		84,716.22		28,636.75
Cleaning and sanitation		<u>2,171.00</u>		<u>1,644.94</u>
			(13,408,951.30)	<u>(10,937,296.50)</u>
<b>INCOME FOR THE YEAR</b>			17,390,316.22	11,694,596.75
<b>INTER YEAR ADJUSTMENT</b>			-	<u>60,725.75</u>
			<u>17,390,316.22</u>	<u>11,755,322.50</u>
<b>PROPRIATION</b>				
Statutory reserve (25%)			4,347,579.06	2,938,830.62
Undistributable profit			<u>13,042,737.17</u>	<u>8,816,491.88</u>
			17,390,316.22	<u>11,755,322.50</u>



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 CASH FLOW STATEMENT  
 FOR THE YEAR ENDED 30 JUNE 2010

	<u>Notes</u>	<u>Birr</u>	<u>Birr</u>	<u>2009</u> <u>Birr</u>
<b>Cash Flows from Operating Activities</b>				
Net income for the year			17,390,316.22	11,694,596.75
Adjustment for:-				
Depreciation and amortization		1,009,859.97		771,852.29
Prior Year adjustment		-		60,725.75
			<u>1,009,859.97</u>	<u>832,578.04</u>
<b>Operating Profit Before Working Capital Charges</b>			<b>18,400,176.19</b>	<b>12,527,174.79</b>
Increase in suspense		(5,700,575.83)		
Increase)/Decrease in inventory		(196,686.76)		40,544.29
Increase in loans receivable		(92,212,641.62)		(75,558,266.29)
Increase/ Increase in interest receivable		123,589.79		1,092,177.62
Increase in prepayments and advance		(7,378,835.55)		(2,900,908.64)
Increase/ Increase in clients savings		41,025,969.41		23,331,005.94
Increase in sundry creditors		<u>11,944,432.03</u>		<u>4,114,699.97</u>
			<u>(52,394,748.53)</u>	<u>(49,880,747.11)</u>
<b>Flows from Investing Activities</b>			<b>(33,994,572.34)</b>	<b>(37,353,572.32)</b>
Investment		(6,000,000.00)		
Construction in Progress		(6,258,256.88)		(29,761.50)
Purchase of Fixed assets and intangible assets		<u>(2,473,608.28)</u>		<u>(1,483,868.04)</u>
			(14,731,865.16)	(1,513,629.54)
<b>Flows from Financing Activities</b>				
Disposal of fixed asset		2,442.00		
Equity administration capital contribution received		50,000,000.00		59,000,000.00
Donated capital obtained		(20,998.92)		
Proceeds from long term loan		(6,067,948.80)		
Principal loan payment		<u>30,000,000.00</u>		<u>(5,241,428.50)</u>
			<u>73,913,494.28</u>	<u>53,758,571.50</u>
<b>(Decrease) increase in cash and cash equivalents</b>			<b>25,187,056.78</b>	<b>14,891,369.64</b>
<b>Cash and cash equivalents at beginning of the year</b>			<u>54,506,843.18</u>	<u>39,615,473.07</u>
<b>Cash and cash equivalents at the end of the year</b>			<u><u>79,693,899.96</u></u>	<u><u>54,506,842.71</u></u>



DIS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 DEBITED TO THE ACCOUNT  
 FOR THE YEAR ENDED 30 JUNE 2010

FIXED ASSETS

COSTS	Balance	Additions	Disposal	Balance
	30/06/09			30/06/10
	<u>Birr</u>	<u>Birr</u>	<u>Birr</u>	<u>Birr</u>
Building	3,614,024.56	641,235.29	-	4,255,259.85
Motor vehicles	2,434,417.00	93,398.40	(26,661.20)	2,501,154.20
Office equipment, Computer and Accessories	1,614,651.00	1,257,361.39	-	2,872,012.39
Office furniture and fixture	642,688.67	446,794.95	-	1,089,483.62
Other assets	33,785.15	34,818.25	-	68,603.40
	<u>8,339,566.38</u>	<u>2,473,608.28</u>	<u>(26,661.20)</u>	<u>10,786,513.46</u>
<b>DEPRECIATION</b>				
Building	432,503.85	216,431.21	-	648,935.06
Motor vehicles	1,071,174.72	379,854.64	(24,219.20)	1,426,810.16
Office equipment, Computer and Accessories	932,701.06	285,776.54	-	1,218,477.60
Office furniture and fixture	285,352.75	84,262.15	-	369,614.90
Other assets	23,524.99	8,374.76	-	31,899.75
	<u>2,745,257.37</u>	<u>974,699.30</u>	<u>(24,219.20)</u>	<u>3,695,737.47</u>
<b>BOOK VALUE</b>	<u>5,594,309.01</u>			<u>7,090,775.99</u>

INTANGIBLE ASSETS

This represents cost of TMS software net of amortization expense for the year as follows:

	<u>Birr</u>	<u>Birr</u>
Cost: BBF		295,300.00
Current year additions		-
		<u>295,300.00</u>
Less: Amortization BBF	(260,138.33)	
Current year addition	<u>(35,160.67)</u>	
		<u>(295,299.00)</u>
		<u>1.00</u>



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 ES TO THE ACCOUNT  
THE YEAR ENDED 30 JUNE 2010

**LOANS RECEIVABLE**

These represent loans disbursed to different Addis Ababa City Kefle Ketemas. The loan balance are expected to be recovered fully within three years. The breakdowns of the balances by Kefle Ketema are as follows:-

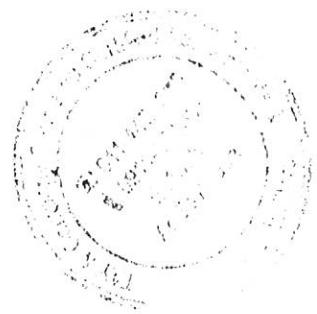
<u>Kifle Ketema</u>	<u>Birr</u>	<u>2009</u> <u>Birr</u>
Addis Ketema	32,883,933.58	28,294,937.09
Arada	29,694,949.96	20,894,139.13
Kolfe	33,473,027.61	26,923,350.44
Meslemele	30,504,711.68	24,226,463.98
Yeka	28,710,455.12	24,191,470.44
Kolfe	31,271,735.88	19,311,315.68
Head Office	35,362,925.08	24,920,483.02
Arada	1,403,694.37	7,837,137.94
Yeka Silk	19,079,264.91	12,304,429.97
Yeka	27,786,041.67	22,383,473.72
Micro Banks - Arada, Kolfe, Yeka and Mes: lemiya	50,809,555.03	54,869,172.05
	95,680,099.02	55,041,445.83
	<u>416,660,393.91</u>	<u>321,197,819.29</u>
Less:- Provision for doubtful loans	(6,793,365.00)	(3,543,432.00)
	<u>409,867,028.91</u>	<u>317,654,387.29</u>

Loans have been shown net of provision provided for non-performing loans.

Interest on loan is accrued on the principal amount of loan outstanding

The adequacy of the allowance for non-performing loan is evaluated quarterly by management. Management provided provisions for non-performing loan every quarter in order to maintain the reserve for non-performing loan at adequate levels. The adequacy of the provision for non performing loan is determined by applying defined percentage to the outstanding loan balance in various aging categories, as follows:

<u>Loan status</u>	<u>Percentage for Allowance</u>
0-90 days overdue	0
91-180 days overdue	25
181-365 days overdue	50
366 days over due	100



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 ES TO THE ACCOUNT  
 THE PERIOD FROM 7 JULY 2008 TO 30 JUNE 2009

SUSPENSE

The break down of the accounts is as follows:-

Suspense	<u>Birr</u>
	7,125,719.86
Less: Provision for doubtful Suspense accounts	<u>(1,425,144.03)</u>
	<u>5,700,575.83</u>

INTEREST RECEIVABLE

This represents interest income earned but not collected on loan disbursed to the clients, less the provision for interest income of non performing loan estimated by the Company's management as follows:

Interest receivable	<u>Birr</u>	<u>2009</u>
	2,419,439.50	<u>Birr</u>
Less: Provision for doubtful interest	<u>(685,211.91)</u>	2,543,029.29
	<u>1,734,227.59</u>	<u>(685,211.91)</u>
		<u>1,857,817.38</u>

REPAYMENTS AND ADVANCES

Repaid others	<u>Birr</u>	<u>2009</u>
Repaid office rent	1,059,051.60	<u>Birr</u>
Off debtors	200,133.40	3,250,979.77
Off long term loan	1,915,035.50	137,833.45
Repaid insurance	145,756.85	1,232,887.72
Receivable from EU	-	155,756.81
Construction Advance	178,262.41	4,813.48
Unauthorized cash withdrawal	8,841,129.43	178,262.41
	<u>285,285.00</u>	<u>285,285.00</u>
	<u>12,624,654.19</u>	<u>5,245,818.64</u>
Less:- Provision for doubtful loans	<u>(285,285.00)</u>	<u>(285,285.00)</u>
	<u>12,339,369.19</u>	<u>4,960,533.64</u>



IS CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 ES TO THE ACCOUNT  
 THE YEAR ENDED 30 JUNE 2010

CASH AND BANK BALANCES

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
Cash at bank	79,672,499.96	53,693,143.18
Cash on hand	6,400.00	22,200.00
etty Cash	5,000.00	54,000.00
aving withdrawal fund	10,000.00	737,500.00
	<u>79,693,899.96</u>	<u>54,506,843.18</u>

CLIENT'S SAVINGS

Client savings comprise interest bearing compulsory, group, center, security, voluntary and non-borrowers savings. Group center and voluntary savings are savings which clients save at their own interest. Compulsory and security savings are group savings maintained as guarantee of the loan whereby the borrowers undertake to be liable jointly and severally for defaulted loan of any one of group members as per by law of the institution. The detail of the balance is listed here below:-

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
ime Deposit - ABATTOIRS	10,000,000.00	10,000,000.00
ime Deposit - TEFERI	195,000.00	-
ompulsory	11,251,555.12	9,396,574.69
roup	1,099,356.83	1,552,516.63
enter	517,286.69	668,794.86
ecurity	30,739,155.11	28,169,063.13
oluntary	16,037,384.91	9,134,201.42
on borrowers savings	49,637,438.97	23,441,340.98
nsurance savings	1,277,722.96	1,275,461.50
nsurance premium	4,106,240.31	2,451,071.73
arking	2,253,853.45	-
	<u>127,114,994.35</u>	<u>86,089,024.94</u>

UNDRY CREDITORS

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
TV- Payable	6,793,754.70	399,521.35
terest payable	1,449,270.41	577,655.49
redit Association and Social Contribution	39,401.14	34,290.64
ome tax	76,192.95	62,902.41
ension Contribution payable	52,984.93	45,336.70
udit fee	27,600.00	27,600.00
ithholding tax payable	15,397.72	636.29
ccruals	13,186.01	7,409.53
loan payable to customers	770,902.28	770,902.28
hers	5,182,043.32	1,373,437.35
ird party deposit	2,226,220.36	173,777.79
yroll fund	-	356,040.28
ilding contribution	173,336.63	-
cial Security	1,982,374.55	3,028,722.86
	<u>18,802,665.00</u>	<u>6,858,232.97</u>

**S CREDIT AND SAVING INSTITUTION SHARE COMPANY**  
**AS TO THE ACCOUNT**  
**FOR THE YEAR ENDED 30 JUNE 2010**

**LONG TERM LOAN- DBE**

The company obtained long term loan of Birr 8,703,000 from Development Bank of Ethiopia in the previous years at interest rate of 6% per annum. The loan is repayable in ten equal semi annual installments of Birr 870,300 on January 31 and July 31 of each year starting on July 31, 2012 up to January 31, 2017.

**MEDIUM TERM LOAN- CBE**

The company also obtained long term loan of Birr 20,000,000 from Commercial Bank of Ethiopia in the previous years at interest rate of 5.2% per annum. The loan is repayable in equal monthly installments of Birr 522,318 starting from 28 February 2007 up to August 8, 2010.

The break down of the loan balance of Commercial Bank of Ethiopia is shown below:-

	<u>Birr</u>
Outstanding loan balance	1,504,282.70
Current maturity	<u>(1,504,282.70)</u>
Medium term portion	<u>-</u>

The company also obtained long term loan of Birr 30,000,000.00 from Commercial Bank of Ethiopia in the April 2010 at interest rate of 6.25% per annum. The loan is repayable in equal monthly installments of Birr 707,994.60 starting from 21 April 2011 up to April 20, 2015. The loan has a one year provision period.

**CITY ADMINISTRATION CAPITAL**

The amount represents budgetary grant obtained from Addis Ababa City Government the details are as follows:-

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
Balance brought forward at the institution's establishment date	1,661,670.00	1,661,670.00
Grant received from Region 14 Finance Bureau:-		
- For purchase of Fixed asset	788,848.00	788,848.00
- For additional loan disbursement	46,048,023.00	46,048,023.00
Collection of Addis Ababa City Government Loans	1,662,156.00	1,662,156.00
Additional fund from Central Treasury	231,517,683.00	181,517,683.00
Amount transferred to capital	365,510.00	365,510.00
Amount received in cash from Women's Affairs Bureau	69,500.00	69,500.00
Others	79,560.00	79,560.00
	<u>282,192,950.00</u>	<u>232,192,950.00</u>



CREDIT AND SAVING INSTITUTION SHARE COMPANY  
 TO THE ACCOUNT  
 YEAR ENDED 30 JUNE 2010

CONTRIBUTION CAPITAL

Received from:-

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
Government of Addis Ababa HIV/AIDS premonition and control office	84,375.00	84,375.00
Community Development Ethiopia Siddhartha Foundation Belgium	70,000.00	70,000.00
received from EU	2,000,000.00	2,000,000.00
received from ANPPCAN Ethiopia	15,000.00	15,000.00
Ababa City Women Democratic Association Prior to the		
Establishment of the Institution	56,001.08	77,000.00
Integrated Family Service Organization	100,000.00	100,000.00
Ababa City Government Social and Labour Affair Bureau	614,118.00	614,118.00
International	583,581.00	583,581.00
Community development service	24,200.00	24,200.00
for H.S.I Children's Home Relief Organization	100,000.00	100,000.00
Ethiopia	872,820.00	872,820.00
Centers of Charity Urban Development Project	194,175.00	194,175.00
Corps	78,024.00	78,024.00
	<u>4,792,294.08</u>	<u>4,813,293.00</u>

RESERVE

brought forward  
 year appropriation

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
brought forward	9,439,669.62	6,500,839.00
year appropriation	4,347,579.06	2,938,830.62
	<u>13,787,248.68</u>	<u>9,439,669.62</u>

DISTRIBUTIONAL PROFIT

brought forward  
 year appropriation

	<u>Birr</u>	<u>2009</u> <u>Birr</u>
brought forward	28,319,008.88	19,502,517.00
year appropriation	13,042,737.17	8,816,491.88
	<u>41,361,746.05</u>	<u>28,319,008.88</u>

OTHER INCOME

pass books  
 from savings  
 other income  
 income  
 back of non performing loan  
 income on time deposit

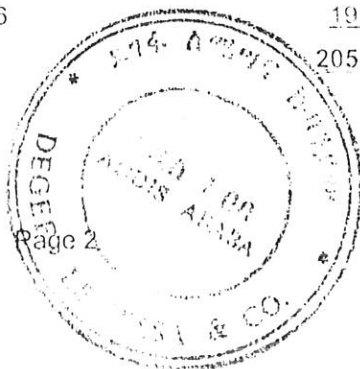
	<u>Birr</u>	<u>2009</u> <u>Birr</u>
pass books	56,914.20	43,222.07
from savings	7,439.58	15,720.89
other income	2,616,523.70	2,194,348.10
income	501,675.47	418,275.06
back of non performing loan	2,187,186.10	1,586,011.72
income on time deposit	271,067.79	93,100.84
	-	930,500.00
	-	348,296.50
	<u>5,640,806.84</u>	<u>5,629,475.18</u>



**ADDIS CREDIT AND SAVING INSTITUTION SHARE COMPANY**  
**BALANCE SHEET**

AS AT 30 SENE 2000 (7 JULY 2008)

	<u>NOTES</u>	<u>BIRR</u>	<u>BIRR</u>	<u>1999</u> <u>BIRR</u>
<b>ASSETS EMPLOYED</b>				
<b>FIXED ASSETS (NET)</b>	2a,4 2e,5		4,837,652	<u>3,823,579</u>
<b>INTANGIBLE ASSET</b>			79,803	<u>138,863</u>
<b>CURRENT ASSETS</b>				
Office and stationery supplies	3d	406,142		501,062
Loans receivable	6	242,096,121		171,206,398
Interest receivable	7	2,949,995		366,165
Prepayments and advances	8	2,059,625		1,238,201
Cash and bank balances	9	<u>39,615,473</u>		<u>58,773,939</u>
		<u>287,127,356</u>		<u>232,085,765</u>
<b>CURRENT LIABILITIES</b>				
Clients savings	10	62,758,019		49,647,197
Sundry creditors	11	2,743,533		1,005,752
Medium term loan - current maturity	12	<u>6,267,816</u>		<u>6,267,816</u>
		<u>71,769,368</u>		<u>56,920,765</u>
Current assets			<u>215,357,988</u>	<u>175,165,000</u>
Medium term loan	12		<u>220,275,443</u>	<u>179,127,442</u>
Long term loan - DBE	12		(6,545,844)	(12,207,083)
Other assets	12		(8,703,900)	(8,703,000)
			<u>205,026,599</u>	<u>158,217,359</u>
<b>SHARES REPRESENTED BY</b>				
Capital authorized and paid up 10170 shares of Birr 100 par value each			1,017,000	517,000
City Administration Capital	13		173,192,950	138,688,562
Donated capital	14		4,813,293	4,541,094
Legal reserve	15		6,500,839	3,617,676
Non-distributable profit	16		<u>19,502,517</u>	<u>10,853,027</u>
			<u>205,026,599</u>	<u>158,217,359</u>



**ADDIS CREDIT AND SAVINGS INSTITUTION SHARE COMPANY**  
**INCOME STATEMENT**  
**FOR THE YEAR ENDED 30 SEPTEMBER 2000 (7 JULY 2008)**

	<u>NOTES</u>	<u>BIRR</u>	<u>BIRR</u>	<u>1999</u> <u>BIRR</u>
<b><u>INCOME</u></b>				
Interest income		18,402,845		12,460,765
Service income		<u>2,575,601</u>		<u>1,460,267</u>
			20,978,446	<u>13,921,032</u>
<b><u>FINANCIAL EXPENSE</u></b>				
Interest expense on client saving deposits		2,269,143		1,902,971
Interest expense on bank loan		1,359,808		1,379,550
Provision for doubtful loan		<u>284,584</u>		<u>188,212</u>
			<u>(3,913,535)</u>	<u>(3,470,733)</u>
Other income	17		17,064,911	10,450,299
			<u>3,122,076</u>	<u>2,122,530</u>
			20,186,987	<u>12,572,829</u>
<b><u>GENERAL AND ADMINISTRATIVE EXPENSES</u></b>				
Salaries and related benefits		6,151,042 ✓		4,538,720
Board fee		16,530		20,680
Education and training expenses		64,227		210,368
Telephone		129,640 ✓		92,949
Electricity and water		32,838 ✓		7,811
Repair and maintenance		64,093 ✓		69,992
Office supplies and stationary		433,835		401,172
Fuel and lubricants		109,808		105,277
Depreciation and amortization		495,094 ✓		445,797
Periodicals and advertisement		118,842		88,202
Medical		68,496 ✓		13,306
Uniforms		7,199 ✓		14,035
Entertainment		37,975		4,745
Bank charge		10,714		213,329
Registration and legal fee		284,536		270,638
Professional fee		113,152		150,000
Audit fee		46,000		51,230
Insurance		337,994		17,888
Miscellaneous		56,052		13,152
Office rent		70,324		50,565
Travelling and per diem		5,390		3,894
Cleaning and sanitation		<u>553</u>		<u>27,115</u>
			<u>(8,654,334)</u>	<u>(6,810,865)</u>
Net income for the year			<u>11,532,653</u>	<u>5,761,964</u>
<b><u>APPROPRIATION</u></b>				
Legal serve (25%)			2,883,163	1,440,492
Non-distributable profit			<u>8,649,490</u>	<u>4,321,472</u>
			11,532,653	<u>5,761,964</u>



**ADDIS CREDIT AND SAVING INSTITUTION SHARE COMPANY**  
**CASH FLOW STATEMENT**  
**FOR THE YEAR ENDED 30 SENE 2000 (7 JULY 2008)**

	<u>BIRR</u>	<u>BIRR</u>	<u>1999</u> <u>BIRR</u>
<b><u>Cash Flows from Operating Activities</u></b>			
Net income for the year		11,532,653	<u>5,761,964</u>
Adjustment for:-			
Provision for bad debts	284,584		188,212
Unpaid interest expense on longterm loan - DBE	-		224,609
Depreciation and amortization	<u>495,094</u>		<u>445,749</u>
		<u>779,678</u>	<u>858,570</u>
Operating profit before working capital charges		12,312,331	<u>6,620,534</u>
(Increase) / decrease in inventory	94,920		(117,460)
Increase in loans receivable	(71,174,308)		(51,275,215)
Decrease/ increase in interest receivable	(2,583,830)		(346,715)
Decrease in prepayments and advance	(821,424)		7,832,208
Decrease/ increase in clients savings	13,110,823		8,338,616
Increase in sundry creditors	<u>1,737,781</u>		<u>(158,655)</u>
		<u>(59,636,038)</u>	<u>(35,727,221)</u>
		<u>(47,323,707)</u>	<u>(29,106,687)</u>
<b><u>Cash Flows from Investing Activities</u></b>			
Purchase of fixed assets and intangible assets	<u>(1,450,107)</u>		<u>(806,752)</u>
		(1,450,107)	<u>(806,752)</u>
<b><u>Cash Flows from Financing Activities</u></b>			
Capital contribution	500,000		-
City Administration capital contribution received	34,504,388		28,017,683
Donated capital obtained	272,199		-
Proceeds from long term loan	-		20,000,000
Principal loan payment	<u>(5,661,239)</u>		<u>(1,749,710)</u>
		<u>29,615,348</u>	<u>46,267,973</u>
(decrease) increase in cash and cash equivalents		(19,158,466)	16,354,534
Cash and cash equivalents at beginning of the year		<u>58,773,939</u>	<u>42,419,405</u>
Cash and cash equivalents at the end of the year		<u>39,615,473</u>	<u>58,773,939</u>



4 FIXED ASSETS

	Balance 30/10/99 <u>Birr</u>	Additions <u>Birr</u>	Balance 30/10/00 <u>Birr</u>
<u>COST</u>			
Building	2,819,465	116,493	2,935,958 ✓
Motor vehicles	1,119,417	565,000	1,684,417 ✓
Office equipment, computers & accessories	1,012,433	580,418	1,592,851 ✓?
Office furniture and fixture	429,125	188,196	617,321 ✓?
Other assets	<u>25,151</u>	-	<u>25,151</u> ✓?
	<u>5,405,591</u>	<u>1,450,107</u>	<u>6,855,698</u>
<u>DEPRECIATION</u>			
Building	131,025	134,497	265,522 ✓?
Motor vehicles	704,268	101,953	806,221 ✓?
Office equipment, computers & accessories	538,010	155,610	693,620 ✓?
Office furniture and fixture	188,127	41,711	229,838 ✓?
Other assets	<u>20,582</u>	<u>2,263</u>	<u>22,845</u> ✓?
Book value	<u>1,582,012</u>	<u>436,034</u>	<u>2,018,046</u>
	<u>3,823,579</u>		<u>4,837,652</u>

5 INTANGIBLE ASSETS

This represents cost of TMS software net of amortization expense for the year as follows:

	<u>Birr</u>	<u>Birr</u>	1999 <u>Birr</u>
Cost: BBF			
current year additions		295,300	253,000
		-	<u>42,300</u>
Less: amortization:- BBF	(156,437)	295,300	295,300
- current year addition	<u>(59,060)</u>		(99,492)
			<u>(56,945)</u>
		<u>(215,497)</u>	<u>(156,437)</u>
		<u>79,803</u>	<u>138,863</u>

6 LOANS RECEIVABLE

These represent loans disbursed to different Addis Ababa City Kefle Ketemas. The loan balances are expected to be recovered fully within three years. The breakdowns of the balances by Kefle Ketema are as follows:-

	<u>Birr</u>	1999 <u>Birr</u>
<u>Kifle Ketema</u>		
Addis Ketema	23,306,479	16,965,303
Akaki	16,998,906	12,661,966
Arada	22,673,866	9,690,614
Bole	19,587,841	15,293,418
Gulele	20,279,497	16,495,916



Gulele	20,279,497	16,495,916
Kirkos	14,403,409	12,130,467
Kolfe	18,929,306	15,160,946
Head office	9,103,851	3,821,423
Lideta	10,773,361	11,631,334
Nifas silk	19,210,344	12,839,469
Yeka	47,562,067	46,064,829
Micro banks - Arada, Kolfe, & Yeka	<u>21,101,066</u>	-
	243,929,992	172,755,685
Less: provision for doubtful loans	<u>(1,833,871)</u>	<u>(1,549,287)</u>
	<u>242,096,121</u>	<u>171,206,398</u>

### INTEREST RECEIVABLE

This represents uncollected interest income on loan disbursed to the clients, less the expected doubtful interest estimated by the Company's management as follows:-

	<u>Birr</u>	<u>1999 Birr</u>
Interest receivable	3,635,207	2,739,486
Less: provision for doubtful interest	<u>(685,212)</u>	<u>(2,373,321)</u>
	<u>2,949,995</u>	<u>366,165</u>

### PREPAYMENTS AND ADVANCES

	<u>Birr</u>	<u>1999 Birr</u>
Prepaid office rent	62,383	68,166
Staff debtors	1,566,914	409,677
Staff long term loan	210,775	291,779
Prepaid insurance	41,291	4,607
Receivable from E.U	178,262	400,000
Unauthorized cash withdrawal	285,285	285,285
Other receivable	-	<u>63,972</u>
	2,344,910	1,523,486
Less: provision for doubtful debts	<u>(285,285)</u>	<u>(285,285)</u>
	<u>2,059,625</u>	<u>1,238,201</u>

### CASH AND BANK BALANCES

	<u>Birr</u>	<u>1999 Birr</u>
Cash at bank	39,613,873	58,270,139
Cash in hand	<u>1,600</u>	<u>3,800</u>
	<u>39,615,473</u>	<u>58,273,939</u>



10 CLIENT'S SAVINGS

Client savings comprise interest bearing compulsory, group, center, security, voluntary and non-borrowers savings. Group, center and voluntary savings are savings which clients save at their own interest. Compulsory and security savings are group savings maintained as guarantee of the loan whereby the borrowers undertake to be liable jointly and severally for defaulted loan of any one of group members as per by law of the institution. The detail of the balance is listed here below:-

	<u>Birr</u>	<u>1999</u> <u>Birr</u>
Compulsory	8,092,502	3,249,659
Group	1,082,689	865,411
Center	645,744	711,908
Security	25,179,929	24,000,087
Voluntary	5,118,787	3,094,729
Non borrowers savings	19,886,291	14,907,004
Insurance savings	1,112,589	548,130
Insurance premium	1,639,488	2,108,505
Unclassified old clients savings	-	161,764
	<u>62,758,019</u>	<u>49,647,197</u>

11 SUNDRY CREDITORS

	<u>Birr</u>	<u>1999</u> <u>Birr</u>
Interest payable ✓	450,557 ✓	-
Credit Association and Social Contribution ✓	28,206 ✓	23,327
Income tax	52,287 ✓	32,374
Pension Contribution payable	39,581 ✓	28,146
Audit fee	46,000 ✓	80,500
Withholding tax payable	11,737 ✓	219
Accruals	4,252 ✓	10,854
Loan payable to customers <i>Alkawa Jeba</i>	770,902 ✓	670,893
Others	1,083,195 ✓	159,339
Third party deposit	<u>256,816</u> ✓	-
	<u>2,743,533</u>	<u>1,005,652</u>

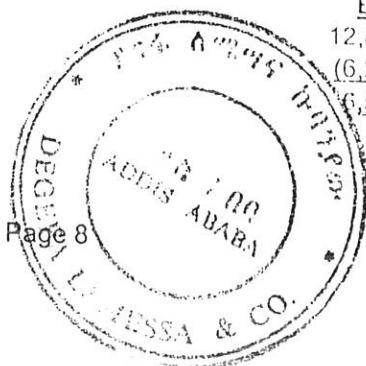
2 LONG TERM LOAN

The company obtained long term loan of Birr 8,003,000 from Development Bank of Ethiopia in the previous years at interest rate of 6% per annum. The loan is repayable in ten equal semi annual installments of Birr 870,300 on January 31 and July 31 of each year starting on July 31, 2012 up to January 31, 2017. The company also obtained long term loan of Birr 20,000,000 from Commercial Bank of Ethiopia in the previous year at interest rate of 5.2% per annum. The loan is repayable in equal monthly installments of Birr 522,318 starting from 28 February 2007 up to August 8, 2010.

Out of the total loan, Birr 5,661,239 has been paid this year.

The break down of the loan balance of Commercial Bank of Ethiopia is shown below:

	<u>Birr</u>
Outstanding loan balance	12,813,660
Current maturity	(6,267,816)
Medium term portion	6,545,844



CITY ADMINISTRATION CAPITAL

The amount represents budgetary grant obtained from Addis Ababa City Government.  
The details are as follows:-

	<u>Birr</u>	<u>1999 Birr</u>
Balance brought forward at the institution's establishment date	1,661,670	1,661,670
Cash grant received from Region 14 Finance Bureau:-		
- For purchase of fixed asset	788,848	788,848
- For additional loan disbursement	46,048,023	46,048,023
Collection of Addis Ababa City Government Loans	1,662,156	1,662,156
Additional fund from Central Treasury	122,517,683	88,017,683
Loans transferred to capital	365,510	365,510
Grant received in cash from Women's Affairs Bureau	69,500	69,500
Others	79,560	75,172
	<u>173,192,950</u>	<u>138,688,562</u>

DONATED CAPITAL

	<u>Birr</u>	<u>1999 Birr</u>
Grant received from:-		
- Government of Addis Ababa HIV/AIDS premonition and control office	84,375	84,375
- Family Development Ethiopia Siddartha Foundation Belgium	70,000	70,000
- Grant received from EU.	2,000,000	2,000,000
- Grant received from ANPPCAN Ethiopia	15,000	15,000
- Addis Ababa City Woman Democratic Association prior to the establishment of the Institution	77,000	77,000
- Integrated Family Service Organizaiton	100,000	100,000
- Addis Ababa City Government Social and Labour Affair Bureau	614,118	614,118
- Plan International	583,581	583,581
- Community development service	24,200	24,200
- Former H.S.I. Childeren's Home Relief Organization	100,000	100,000
- Plan Ethiopia	872,820	872,820
- Doughters of Charity Urban Development Project	194,175	-
- Merci corps	78,024	-
	<u>4,813,293</u>	<u>4,541,094</u>

FUNDING RESERVE

	<u>Birr</u>	<u>1999 Birr</u>
Balance brought forward	3,617,676	2,177,184
Current year appropriation	2,883,163	1,440,492
	<u>6,500,839</u>	<u>3,617,676</u>



ON DISTRIBUTABLE PROFIT

Balance brought forward  
Current year appropriation

<u>Birr</u>	<u>1999 Birr</u>
10,853,027	6,531,555
<u>8,649,490</u>	<u>4,321,472</u>
<u>19,502,517</u>	<u>10,853,027</u>

OTHER INCOME

Sales of pass books  
Interest from savings  
Insurance income  
Commission  
Registration fee  
Others  
Donation income  
Penalty

<u>Birr</u>	<u>1999 Birr</u>
39,053	37,154
566,967	1,031,529
1,178,001	409,162
3,301	-
-	11,602
190,537	82,059
6,006	26,668
<u>1,138,211</u>	<u>524,356</u>
<u>3,122,076</u>	<u>2,122,530</u>

